

Supreme Court of the United States

OCTOBER TERM, 1965

No. 127

UNITED STATES, PETITIONER

vs.

CHARLES E. O'MALLEY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE SEVENTH CIRCUIT

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**IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

No. 58C76

[File Endorsement Omitted]

**CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER
G. FARROW, as Executors of the Will of Edward H.
Fabrice, Deceased, PLAINTIFFS,**

vs

THE UNITED STATES OF AMERICA, DEFENDANT

COMPLAINT—Filed January 15, 1958

The plaintiffs, CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER G. FARROW, as Executors of the Will of Edward H. Fabrice, Deceased, by their attorneys, THOMPSON, RAYMOND, MAYER, JENNER & BLOOMSTEIN, complain of the defendant and aver as follows:

(1) This action is for refund of the federal estate tax paid to defendant by plaintiffs, as Executors of the Will of Edward H. Fabrice, Deceased, and this action arises under the Internal Revenue Code of 1939 (former 26 U.S.C., Sec. 1, et seq). This court has jurisdiction on this action under 28 U.S.C., Sec. 1346.

(2) Plaintiffs are residents of the Northern District of Illinois.

(3) Edward H. Fabrice (herein referred to as "Fabrice") died a resident of Chicago, Cook County, Illinois, [fol. 5] on October 13, 1949. Prior to his death Fabrice had created five irrevocable trusts, naming himself as a co-trustee of each. Two of the five trusts were created on December 21, 1936—one (herein referred to as "Janet Fabrice Trust No. 1") for the benefit of his daughter Janet, and the other (herein referred to as "Lorraine Fabrice Trust No. 1") for the benefit of his daughter Lorraine. The remaining three trusts were created on January 20, 1937—one (herein referred to as "Janet Fabrice Trust No. 2") for the benefit of his daughter Janet, another (herein referred to as "Lorraine Fabrice Trust No. 2") for the benefit of his daughter Lorraine, and the last (herein referred to as "Martha G. Fabrice Trust") for the benefit of his wife Martha. Copies of each of the five trust agreements are attached hereto as Exhibits "A" through "E".

(4) Upon the creation of the Janet Fabrice Trust No. 1, Fabrice transferred to it seventy-five (75) shares of a closely-held Illinois corporation, then known as Fabart Company, and now known as Fabart Instrument Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

[fol. 6]

	Dividends Received	Interest Received On Bonds Purchased By The Trustees From Income
1937	\$6,150.00	
1938		\$ 322.87
1939	3,000.00	107.63
1940	5,250.00	
1941	5,880.00	
1942	7,480.00	120.00
1945	2,805.00	208.68
1946	5,610.00	208.68
1947		208.68
1948		208.68
1949	2,805.00	
	<hr/> \$38,980.00	<hr/> \$1,385.22
		TOTAL INCOME.....\$40,365.22

With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On February 8, 1939—30 shares
On February 9, 1940—42 shares
On March 6, 1941 —40 shares

The total price paid for these 112 shares was \$11,200.00, which, when added to the amounts distributed and otherwise expended by that trust until Fabrice's death, equalled \$39,559.93. The total income of the Janet Fabrice Trust No. 1 of \$40,365.22, less \$39,559.93 in disbursements, left cash on hand as of October 13, 1949, of \$805.29.

(5) Upon the creation of the Lorraine Fabrice Trust No. 1, Fabrice transferred to it seventy-five (75) of Fab-[fol. 7] art Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	Dividends Received	Interest Received On Bonds Purchased By The Trustees From Income
1937	\$6,150.00	\$
1939	3,000.00	
1940	5,250.00	
1941	5,880.00	
1942	7,480.00	120.00
1945	2,805.00	
1946	5,610.00	
1949	2,805.00	
	<hr/>	<hr/>
	\$38,980.00	\$ 120.00
TOTAL INCOME.....\$39,100.00		

With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On February 8, 1939—30 shares
On February 9, 1940—42 shares
On March 6, 1941 —40 shares

The total price paid for these 112 shares was \$11,200.00, which, when added to the amounts distributed and

otherwise expended by that trust until Fabrice's death, equaled \$31,484.05. The total income of the Lorraine [fol. 8] Fabrice Trust No. 1 of \$39,100.00, less \$31,484.05 in disbursements, left cash on hand as of October 13, 1949, of \$7,615.95.

(6) Upon the creation of the Janet Fabrice Trust No. 2, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	Dividends Received	Interest Received On Bonds Purchased By The Trustees From Income
1937	\$ 8,282.00	\$
1938		434.85
1939	4,040.00	144.89
1940	7,050.00	
1941	7,880.00	
1942	10,120.00	84.00
1943		252.00
1945	3,795.00	77.23
1946	7,590.00	32.83
1947		15.12
1948		15.12
1949	3,795.00	
	<hr/> \$52,552.00	<hr/> \$1,056.04
TOTAL INCOME.....		\$53,608.04

With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

[fol. 9]

On March 7, 1939 —40 shares
On February 9, 1940—56 shares
On March 6, 1941 —56 shares

The total price paid for these 152 shares was \$15,200.00, which, when added to the amounts distributed and otherwise expended by that trust until Fabrice's death, equaled \$40,620.32. The total income of the Janet Fabrice Trust No. 2 of \$53,608.04, less \$40,620.32 in dis-

bursements, left cash on hand as of October 13, 1949, of \$12,987.72.

(7) Upon the creation of the Lorraine Fabrice Trust No. 2, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	<u>Dividends Received</u>	<u>Interest Received On Bonds Purchased By The Trustees From Income</u>
1937	\$ 8,282.00	\$
1939	4,040.00	
1940	7,050.00	
1941	7,880.00	
1942	10,120.00	382.50
1943		252.00
1945	3,795.00	
1946	7,590.00	
1949	3,795.00	
	<u>\$52,552.00</u>	<u>\$ 634.50</u>

TOTAL INCOME.....\$53,186.50

[fol. 10] With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On March 7, 1939 —40 shares
On February 9, 1940—56 shares
On March 6, 1941 —56 shares

The total price paid for these 152 shares was \$15,200.00, which, when added to the amounts distributed and otherwise expended by that trust until Fabrice's death, equaled \$40,589.15. The total income of the Lorraine Fabrice Trust No. 2 of \$53,186.50, less \$40,589.15 in disbursements, left cash on hand as of October 13, 1949, of \$12,597.35.

(8) Upon the creation of the Martha G. Fabrice Trust, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

Dividends Received

1937	\$ 8,282.00
1939	4,040.00
1940	7,050.00
1941	7,880.00
1942	10,120.00
1945	3,795.00
1948	7,590.00
1949	3,795.00

TOTAL INCOME.....\$52,552.00

[fol. 11] With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On March 7, 1939 —40 shares
On February 9, 1940—56 shares
On March 6, 1941 —56 shares

The total price paid for these 152 shares was \$15,200.00, which, when added to the amounts distributed and otherwise expended by that trust until Fabrice's death, equaled \$40,212.15. The total income of the Martha G. Fabrice Trust of \$52,552.00, less \$40,212.15, left cash on hand as of October 13, 1949, of \$12,339.85.

(9) During his lifetime, Fabrice leased from his daughter Janet, two Wisconsin farms which were beneficially owned by her. Fabrice also leased from his daughter Lorraine, one Wisconsin farm which was beneficially owned by her. Fabrice, as a tenant, erected certain buildings and other improvements on such farms. Rent was paid by Fabrice for those farms. The recipient of that rental income reported it on federal income tax returns and took deduction on those returns for depreciation on such improvements.

(10) After the death of Fabrice, plaintiffs were duly qualified on November 3, 1949, by the Probate Court of Cook County, Illinois, as Executors of Fabrice's will and [fol. 12] entered upon their duties as such. On February 12, 1951, plaintiffs filed for the Estate of Fabrice a federal estate tax return, properly executed, showing no federal estate tax due. On February 2, 1954, the Commissioner of Internal Revenue determined that the estate tax

liability of the Estate of Fabrice was \$80,726.36, and assessed a deficiency in estate tax of that amount. The major items added to Fabrice's gross estate by the Commissioner were as follows:

(a) *Janet Fabrice Trust No. 1*

112 shares of Fabart Company
stock given to the trust by
Fabrice

75 shares of purchased Fabart
Company stock

187 shares at \$200 each.....	\$37,400.00	
Cash	805.29	\$38,205.29

(b) *Lorraine Fabrice Trust No. 1*

112 shares of Fabart Company
stock given to the trust by
Fabrice

75 shares of purchased Fabart
Company stock

187 shares at \$200 each.....	\$37,400.00	
Cash	7,615.95	\$45,015.95

(c) *Janet Fabrice Trust No. 2*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of purchased Fabart
Company stock

253 shares at \$200 each.....	\$50,600.00	
Cash	12,987.72	\$63,587.72

[fol. 13]

(d) *Lorraine Fabrice Trust No. 2*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of purchased Fabart
Company stock

253 shares at \$200 each.....	\$50,600.00	
Cash	12,597.35	\$63,197.35

(e) *Martha G. Fabrice Trust*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of purchased Fabart
Company stock

253 shares at \$200 each.....	\$50,600.00	
Cash	12,339.85	
Plus an amount not identi- fied in the deficiency letter, but equal to	3,795.00	\$66,734.85

(f) Farm Improvements

37,000.00

\$313,741.16

On August 5, 1954, plaintiffs paid to the Director of Internal Revenue in Chicago, Illinois, the amount of the claimed deficiency in federal estate tax, together with interest of \$16,774.49, for a total of \$97,500.85.

(11) On August 3, 1956, plaintiffs filed with the District Director of Internal Revenue in Chicago, Illinois, a properly executed claim for refund of the \$97,500.85 paid as federal estate tax and interest. By said claim, plaintiffs asked refund of the amount of tax and interest [fol. 14] paid upon the ground that the entire corpus of each of the five trusts herein referred to was erroneously included in Fabrice's estate under Section 811(c) (1) (B) (ii) and/or Section 811 (d) (1) of the 1939 Internal Revenue Code. In briefs filed with the Director in support of the claim, plaintiffs argued that—

A. The entire corpus of each trust, including the accumulated income (whether re-invested or in cash), should be excluded from the gross estate because the power under each trust to accumulate income was and is governed by a definite external standard;

B. The accumulated income portion of the corpus of each trust (whether re-invested or in cash), as distinguished from the original principal transferred by Fabrice, was erroneously included in the gross estate, for such income was not "transferred" by Fabrice; and

C. The farm improvements were erroneously included in Fabrice's estate under Section 811(c) (1) (B) (i), for Fabrice did not retain the "possession or enjoyment" of such improvements.

[fol. 15] (12) On April 24, 1957, the District Director disallowed the claim of plaintiffs, whereupon plaintiffs filed a protest, with supporting briefs, again stating their position. On September 24, 1957, the Office of the Regional Commissioner sent to plaintiffs a notice of formal disallowance of their claim.

(13) For the reasons stated in Subparagraphs "A" through "C" of Paragraph (11) hereof, the assessment by the Commissioner against the estate of Fabrice of the alleged deficiency in federal estate tax referred to in this complaint was erroneous and excessive, and the collection by the Commissioner of that tax, together with the interest thereon, was also erroneous.

(14) Plaintiffs have incurred and will incur attorneys' fees in the prosecution of their claim for refund and in the prosecution of this suit for refund of federal estate taxes. The amount of such fees are not at this time determined, but such fees are a proper administrative expense which should be deducted from the gross estate of Fabrice in the ultimate determination of estate tax, if any.

WHEREFORE, plaintiffs demand judgment in their favor and against the defendant—

[fol. 16] (a) In the amount of \$97,500.85, plus interest to date; or

(b) For such amount less than \$97,500.85, plus interest to date, as the Court may find proper, but in such case the amount of the ultimate recovery to reflect as a deduction from the gross estate of Fabrice the attorneys' fees incurred by plaintiffs in

presenting their claim to the District Director and in prosecuting this suit; and

(c) For such other relief as may be proper.

/s/ Max Bloomstein, Jr.

/s/ Addis E. Hull

/s/ Leon Fieldman

Thompson Raymond Mayer Jenner & Bloomstein
135 South LaSalle Street
Chicago-3, Illinois.
Randolph 6-0220

Of Counsel

[fols. 17-50] * * *

[fol. 51]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[File Endorsement Omitted]

[Title Omitted]

ANSWER—Filed March 17, 1958

Comes now the defendant, United States of America, by its attorneys, Robert Tieken, United States Attorney for the Northern District of Illinois, and Donald S. Lowitz, Assistant United States Attorney, and for its answer to plaintiffs' complaint alleges as follows:

1. Admits the allegations contained in paragraph 1 of plaintiffs' complaint, except to deny that plaintiffs are entitled to the refund they seek.

2. Admits the allegations contained in paragraph 2 of plaintiffs' complaint.

3. Admits the allegations contained in paragraph 3 of plaintiffs' complaint, except to deny that the trusts referred to therein were irrevocable.

4. Admits the 1st sentence of paragraph 4 of plaintiffs' complaint. Denies information sufficient to form a belief [fol. 52] as to the truth of all other matters alleged in paragraph 4, except to admit that the Janet Fabrice Trust No. 1 had cash on hand as of October 13, 1949, of \$805.29.

5. Admits the 1st sentence of paragraph 5 of plaintiffs' complaint. Denies information sufficient to form a belief as to the truth of all other matters alleged in paragraph 5, except to admit that the Lorraine Fabrice Trust No. 1 had cash on hand as of October 13, 1949, of \$7,615.95.

6. Admits the 1st sentence of paragraph 6 of plaintiffs' complaint. Denies information sufficient to form a belief as to the truth of all other matters alleged in paragraph 6, except to admit that the Janet Fabrice Trust No. 2 had cash on hand as of October 13, 1949, of \$12,987.72.

7. Admits the 1st sentence of paragraph 7 of plaintiffs' complaint. Denies information sufficient to form a belief as to the truth of all other matters alleged in paragraph 7, except to admit that the Lorraine Fabrice Trust No. 2 had cash on hand as of October 13, 1949, of \$12,597.35.

8. Admits the 1st sentence of paragraph 8 of plaintiffs' complaint. Denies information sufficient to form a belief as to the truth of all other matters alleged in paragraph 8, except to deny that the Martha G. Fabrice trust had cash on hand as of October 13, 1949 of \$12,339.85.

[fol. 53] 9. Denies information at this time sufficient to form a belief as to the truth of the allegations contained in paragraph 9 of plaintiffs' complaint, except to admit that Fabrice paid rent for the farms and erected buildings on them, and to deny the last sentence of paragraph 9.

10. Admits the allegations contained in the first three sentences of paragraph 10 of plaintiffs' complaint, except to allege that the deficiency referred to was assessed on June 30, 1954, rather than February 2, 1954, as alleged.

Admits that the major items added to Fabrice's gross estate totaled \$313,741.61 as alleged, but denies that the

complaint sets out the particulars of said total correctly in paragraphs (a) through (f).

Admits the last sentence of paragraph 10, except to allege that the payments were made on August 6, 1954.

11. Admits the allegations contained in paragraph 11 of plaintiffs' complaint, except to deny that plaintiffs' alleged grounds for claiming a refund entitle them to the relief they seek.

12. Admits the allegations contained in paragraph 12 of plaintiffs' complaint.

13. Denies the allegations contained in paragraph 13 of plaintiffs' complaint.

[fol. 54] 14. Denies the allegations contained in paragraph 14 of plaintiffs' complaint.

WHEREFORE, defendant demands that judgment be entered dismissing plaintiffs' complaint and granting to defendant costs.

/s/ R. Tieken
ROBERT TIEKEN
United States Attorney

/s/ Donald S. Lowitz
DONALD S. LOWITZ
Assistant United States Attorney

[fol. 55]

[AFFIDAVIT OF MAILING (Omitted in Printing)]

[fols. 56-65] * * *

[fol. 66]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[File Endorsement Omitted]

[Title Omitted]

STIPULATION—Filed May 6, 1960

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true for the purpose of this proceeding, provided, however, that this stipulation shall be without prejudice to the right of the parties hereto to object to the relevancy or materiality of any fact herein stated.

1. This action is for refund of the federal estate tax paid to defendant by plaintiffs, CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER G. FARROW as executors of the will of Edward H. Fabrice, deceased, and this action arises under the Internal Revenue Code of 1939 (former 26 U.S.C., Sec. 1, et seq). Plaintiffs are residents of the Northern District of Illinois and this court has jurisdiction of this action under 28 U.S.C., Sec. 1346.

[fol. 67] 2. Edward H. Fabrice (herein referred to as "Fabrice") died a resident of Chicago, Cook County, Illinois, on October 13, 1949. Prior to his death Fabrice had created five trusts, naming himself, Peter G. Farrow, and Mary L. Schick as co-trustees of each. Paragraph (d) of Article II of each trust agreement provides that the trust may not be revoked by the settlor. Two of the five trusts were created on December 21, 1936—one (herein referred to as "Janet Fabrice Trust No. 1") for the benefit of Fabrice's daughter Janet, and the other (herein referred to as "Lorraine Fabrice Trust No. 1") for the benefit of his daughter Lorraine. The remaining three trusts were

created on January 20, 1937—one (herein referred to as “Janet Fabrice Trust No. 2”) for the benefit of Fabrice’s daughter Janet, another (herein referred to as “Lorraine Fabrice Trust No. 2”) for the benefit of his daughter Lorraine, and the last (herein referred to as “Martha G. Fabrice Trust”) for the benefit of his wife Martha. True and correct copies of each of the five trust agreements are attached hereto as Exhibits “A” through “E” and paragraphs 7 through 11 hereof give the financial details concerning each such trust.

3. During his lifetime, Fabrice leased from his daughter Janet, two Wisconsin farms which were beneficially owned by her. Fabrice also leased from his daughter Lorraine, one Wisconsin farm which was beneficially owned by her. The leases for these three farms were not in [fol. 68] writing. Fabrice, as a tenant, erected certain buildings and other improvements on such farms and took deductions on his federal income tax return for depreciation on the buildings and other improvements which he erected. Rent was paid by Fabrice for those farms. The recipient of that rental income reported it on federal income tax returns and took deductions on those returns for depreciation on permanent improvements which had been located on the farms at the time that she acquired the farms. Fabrice was a tenant of the farms and continued to occupy them and to use the improvements thereon until the date of his death.

4. After the death of Fabrice, plaintiffs were duly qualified on November 3, 1949, by the Probate Court of Cook County, Illinois, as executors of Fabrice’s will and entered upon their duties as such. On February 12, 1951, plaintiffs filed for the estate of Fabrice a federal estate tax return, properly executed, showing no federal estate tax due. On June 30, 1954, the Commissioner of Internal Revenue determined that the estate tax liability of the estate of Fabrice was \$80,726.36, and assessed a deficiency in estate tax of that amount. The major items added to Fabrice’s gross estate by the Commissioner were as follows (the Fabart Company stock referred to had a value of \$200.00 per share at the time of the creation of each of the trusts and at the time of Fabrice’s death) :

(a) *Janet Fabrice Trust No. 1*

75 shares of Fabart Company stock given to the trust by Fabrice		
112 shares of Fabart Company stock purchased by the trust		
187 shares at \$200 each.....	\$37,400.00	
Cash	805.29	\$38,205.29

[fol. 69]

(b) *Lorraine Fabrice Trust No. 1*

75 shares of Fabart Company stock given to the trust by Fabrice		
112 shares of Fabart Company stock purchased by the trust		
187 shares at \$200 each.....	\$37,400.00	
Cash	7,615.95	\$45,015.95

(c) *Janet Fabrice Trust No. 2*

101 shares of Fabart Company stock given to the trust by Fabrice		
152 shares of Fabart Company stock purchased by the trust		
253 shares at \$200 each.....	\$50,600.00	
Cash	12,987.72	\$63,587.72

(d) *Lorraine Fabrice Trust No. 2*

101 shares of Fabart Company stock given to the trust by Fabrice		
152 shares of Fabart Company stock purchased by the trust		
253 shares at \$200 each.....	\$50,600.00	
Cash	12,597.35	\$63,197.35

(e) *Martha G. Fabrice Trust*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of Fabart Company
stock purchased by the trust

253 shares at \$200 each.....	\$50,600.00	
Cash	16,134.85	\$66,734.85

(f) Farm Improvements		37,000.00
		<u>\$313,741.16</u>

On August 6, 1954, plaintiffs paid to the Director of Internal Revenue in Chicago, Illinois, the amount of the claimed deficiency in federal estate tax, together with interest of \$16,774.49, for a total of \$97,500.85.

5. On August 3, 1956, plaintiffs filed with the District [fol. 70] Director of Internal Revenue in Chicago, Illinois, a properly executed claim for refund of the entire \$97,500.85 paid as federal estate tax, and interest thereon. A true and correct copy of said claim is attached hereto as Exhibit F. Thereafter, plaintiffs filed a brief with the Director in support of their claim.

6. On April 24, 1957, the District Director disallowed the claim of plaintiffs, whereupon on May 23, 1957 plaintiffs filed a properly executed protest, with supporting briefs, again stating their position. A true and correct copy of said protest (except for the statement of facts and brief portions thereof) is attached hereto as Exhibit G. On September 30, 1957, the Office of the Regional Commissioner sent to plaintiffs a notice of formal disallowance of their claim.

7. Upon the creation of the Janet Fabrice Trust No. 1, Fabrice transferred to its seventy-five shares of a closely held Illinois corporation, then known as Fabart Company, and now known as Fabart Instrument Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	<u>Dividends Received</u>	<u>Interest Received On Bonds Purchased by The Trustees from Income</u>
1937	\$ 6,150.00	
1938		\$ 322.87
1939	3,000.00	107.63
1940	5,250.00	
1941	5,880.00	
1942	7,480.00	22.50
1945	2,805.00	208.68
1946	5,610.00	208.68
1947		208.68
1948		208.68
1949	2,805.00	
	<hr/>	<hr/>
	\$38,980.00	\$1,287.72

TOTAL INCOME.....\$40,267.72

[fol. 71] With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On February 8, 1939—30 shares
On February 9, 1940—42 shares
On March 6, 1941 —40 shares

The total price paid for these 112 shares was \$11,200.00. Other distributions by the trust were as follows:

	<u>Distribution to Beneficiary:</u>	
1940	\$5,250.00	
1941	1,260.98	
1944	7,000.00	
1945	3,013.68	
1946	5,718.68	
1947	208.68	
1948	208.68	
1949	2,805.00	\$25,465.70
	<hr/>	

Income Taxes Paid:

1938	\$333.50	
1939	8.91	
1940	120.31	
1942	561.94	
1943	1,772.07	2,796.73
	<hr/>	

Total Disbursements:

Taxes	2,796.73	
Distributions to beneficiary	25,465.70	
Fabart stock purchases	11,200.00	<u>\$39,462.43</u>

The total income of the Janet Fabrice Trust No. 1 of \$40,-267.73, less \$39,462.43 in disbursements, left cash on hand as of October 13, 1949, of \$805.29.

8. Upon the creation of the Lorraine Fabrice Trust No. 1, Fabrice transferred to it seventy-five shares of Fabart Company. No other property was ever transferred by [fol. 72] Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	<u>Dividends Received</u>	<u>Interest Received on Bonds Purchased by the Trustees from Income</u>	
1937	\$ 6,150.00		
1939	3,000.00		
1940	5,250.00		
1941	5,880.00		
1942	7,480.00	\$22.50	
1945	2,805.00		
1946	5,610.00		
1949	2,805.00		
	<u>\$38,980.00</u>	<u>\$22.50</u>	\$39,002.50
			Total Income

With a portion of that income, the following additional shares of Fabart Company were purchased by Trustees at \$100.00 per share:

On February 8, 1939—30 shares
On February 9, 1940—42 shares
On March 6, 1941 —40 shares

The total price paid for these 112 shares was \$11,-200.00. Other distributions by the trust were as follows:

Distribution to Beneficiary:

1939	\$6,150.00	
1945	2,805.00	
1946	5,510.00	
1949	2,805.00	\$17,270.00

Income Taxes Paid:

1940	116.00	
1941	277.20	
1942	762.60	
1943	1,760.75	2,916.55

Total Disbursements:

Taxes	2,916.55	
Distributions to beneficiary	17,270.00	
Fabart stock purchases	11,200.00	\$31,386.55

[fol. 73] The total income of the Lorraine Fabrice Trust No. 1 of \$39,002.50, less \$31,386.55 in disbursements, left cash on hand as of October 13, 1949, of \$7,615.95.

9. Upon the creation of the Janet Fabrice Trust No. 2, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	<u>Dividends Received</u>	<u>Interest Received on Bonds Purchased by the Trustees from Income</u>	
1937	\$ 8,282.00		
1938		\$434.85	
1939	4,040.00	144.89	
1940	7,050.00		
1941	7,880.00		
1942	10,120.00		
1943		252.00	
1945	3,795.00	77.23	
1946	7,590.00	32.83	
1947		15.12	
1948		15.12	
1949	3,795.00		
	<u>\$52,552.00</u>	<u>\$972.04</u>	\$53,524.04

With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On March 7, 1939 —40 shares
 On February 9, 1940—56 shares
 On March 6, 1941 —56 shares

The total price paid for these 152 shares was \$15-200.00. Other distributions by the trust were as follows:

[fol. 74]

Distribution to Beneficiary:

1940	\$ 7,050.00	
1941	1,717.45	
1942	4,031.69	
1943	252.00	
1945	3,872.23	
1947	15.12	
1948	15.12	
1949	3,795.00	\$20,748.61

Income Taxes Paid:

1938	528.20	
1939	13.39	
1940	166.80	
1942	813.07	
1943	1,340.24	
1947	1,726.01	4,587.71

Total Disbursements:

Distribution to beneficiary	\$20,748.61	
Taxes	4,587.71	
Fabart Stock Purchases	15,200.00	\$40,536.32

The total income of the Janet Fabrice Trust No. 2 of \$53,-524.04, less \$40,536.32 in disbursements, left on hand as of October 13, 1949, cash of \$12,987.72.

10. Upon the creation of the Lorraine Fabrice Trust No. 2, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

	<u>Dividends Received</u>	<u>Interest Received on Bonds Purchased by the Trustees from Income</u>
1937	\$8,282.00	
1939	4,040.00	
1940	7,050.00	
1941	7,880.00	
1942	10,120.00	\$382.50
1943		252.00
1945	3,795.00	
1946	7,590.00	
1949	3,795.00	
	<hr/> \$52,552.00	<hr/> \$634.50

Total Income.....\$53,186.50

[fol. 75] With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On March 7, 1939 —40 shares
On February 9, 1940—56 shares
On March 6, 1941 —56 shares

The total price paid for those 152 shares was \$15,200.00. Other distributions by the trust were as follows:

Distribution to Beneficiary:

1937	8,282.00	
1942	4,366.00	
1943	252.00	
1945	3,795.00	
1949	3,795.00	\$20,490.00

Income Taxes Paid:

1940	157.60	
1941	456.50	
1942	762.60	
1943	1,350.95	
1944	454.85	
1947	1,716.65	4,899.15

Total Disbursements:

Distribution to beneficiary	20,490.00	
Taxes	4,899.15	
Fabart Stock Purchases	15,200.00	\$40,589.15

The total income of the Lorraine Fabrice Trust No. 2 of \$53,186.50 less \$40,589.15 in disbursements, left cash on hand as of October 13, 1949, of \$12,597.35.

11. Upon the creation of the Martha G. Fabrice Trust, Fabrice transferred to it 101 shares of Fabart Company. No other property was ever transferred by Fabrice to that trust. Income earned by that trust from its creation through October 13, 1949, was as follows:

[fol. 76]

	<u>Dividends</u>	
1937	\$8,282.00	
1939	4,040.00	
1940	7,050.00	
1941	7,880.00	
1942	10,120.00	
1945	3,795.00	
1946	7,590.00	
1949	3,795.00	
		<hr/>
		\$52,552.00

With a portion of that income, the following additional shares of Fabart Company were purchased by the Trustees at \$100.00 per share:

On March 7, 1939 —40 shares
 On February 9, 1940—56 shares
 On March 6, 1941 —56 shares

The total price paid for those 152 shares was \$15,200.00. Other distributions by the trust were as follows:

Distribution to Beneficiary:

1937	\$8,282.00	
1941	2,000.00	
1942	2,000.00	
1945	3,795.00	
		<hr/>
		\$16,077.00

Income Taxes Paid:

1939	157.60	
1940	456.50	
1942	762.60	
1943	1,946.80	
1947	1,716.65	
Legal 1947	100.00	
		<hr/>
		5,140.15

Total Disbursements:

Distribution to beneficiary	16,077.00	
Taxes	5,140.15	
Fabart Stock Purchases	15,200.00	<u>\$36,417.15</u>

The total income of the Martha G. Fabrice Trust of \$52,552.00, less \$36,417.15, left cash on hand as of October 13, 1949, of \$16,134.85.

[fol. 77] 12. Plaintiffs have incurred and will incur attorneys' fees in the prosecution of their claim for refund and in the prosecution of this suit for refund of federal estate taxes. The amount of such fees are not at this time determined.

The parties request that, in the event the court should determine any issue herein involved in favor of the plaintiffs, the record in this cause shall remain open for 60 days within which time the parties are to agree to the amount of the judgment to be entered and in the event the parties cannot so agree, the necessary additional evidence relative to the computation of said judgment may be submitted to the court within said 60 day period.

THE UNITED STATES OF AMERICA

By /s/ R. Tieken
ROBERT E. TIEKEN
United States Attorney

CHARLES E. O'MALLEY
CLAUDE C. ALEXANDER
PETER G. FARROW, as Executors of
the Will of Edward H. Fabrice,
Deceased

By /s/ Addis E. Hull

/s/ Leon Fieldman
Their Attorneys

[fol. 78]

WFC:MH 12/19/36 1&4

EXHIBIT "A" TO STIPULATION

THIS AGREEMENT made and entered into this 21st day of December, A. D. 1936, by and between EDWARD H. FABRICE of the City of Chicago, County of Cook and State of Illinois, hereinafter termed the "Settlor", and EDWARD H. FABRICE, PETER G. FARROW and MARY L. SCHICK of the City of Chicago, County of Cook and State of Illinois, hereinafter termed the "Trustees", WITNESSETH:

That the Settlor, in consideration of the agreements and undertakings hereinafter made by the Trustees, does hereby sell, assign, transfer and set-over unto the Trustees the following described securities to-wit:

Seventy-five (75) shares of the capital stock of Fab-art Instrument Company, an Illinois Corporation, and the Trustees are hereby authorized to and agree that they will receive and hold the said securities and/or such additional securities, cash and real estate or other property as may be transferred, assigned, conveyed, bequeathed, devised or delivered to the Trustees by the Settlor, or by any person, to become a part of the principal of the Trust Estate, and all investments and reinvestments thereof, hereinafter sometimes called the "Trust Estate", and the income therefrom, for the uses and purposes and upon the terms and conditions hereinafter provided, that is to say:

ARTICLE I.

This agreement and the trust hereby evidenced shall be known as and designated as: "THE EDWARD H. FABRICE—JANET FABRICE TRUST".

ARTICLE II.

The Trust Estate shall be distributed both as to income and principal in the following manner:

- (a) The net income from the Trust Estate shall be paid, in whole or in part, to my daughter, JANET FABRICE, in such proportions, amounts and at [fol. 79] such times as the Trustees may, from time to time, in their sole discretion, determine, or said net income may be retained by the Trustees and credited to the account of said beneficiary, and any income not distributed in any calendar year shall become a part of the principal of the Trust Estate.
- (b) The Trustees may, in their sole discretion, instead of paying said income to said beneficiary or applying the same to the account of said beneficiary, use said income for the proper and suitable support and maintenance of said beneficiary and any persons who may be dependent upon her for support in such manner as the Trustees may determine.
- (c) If, because of accident, sickness or other emergency or unusual condition of any kind, the Settlor's said daughter, or any of the daughter's children, shall be in need of funds in addition to the income received by her from all sources within the knowledge of the Trustees, or if the Settlor's said daughter, or any of her children, shall be in need of extra funds for the purpose of providing for the education of the said daughter's children, or any of them, then the Trustees upon the written request of the Settlor's daughter, or any of her children being in need, may withdraw from the principal of the Trust Estate and pay unto the Settlor's said daughter for her own use and benefit, or for that of the daughter's children, or any of them, such sum or sums, at any time and from time to time, as in the absolute opinion of the Trustees shall be reasonably sufficient to relieve their need.
- (d) This trust may not be revoked by the Settlor, but shall terminate upon the happening of any one of the following contingencies:
- (1) At the expiration of twenty-one (21) years from and after the date of this Instrument;
 - (2) Upon the death of the Settlor; or

(3) Upon the death of my daughter, JANET FABRICE;

whichever contingency shall occur first.

- (e) In the event the trust terminates by reason of lapse of time or the death of the Settlor, all property included in the trust shall be distributed to my daughter, JANET FABRICE, if she be then living. In the event the trust shall terminate by reason of the death of my said daughter, JANET FABRICE, then and in that event all property included in the trust shall be distributed in equal shares *per stirpes* and not *per capita* to, between or among, as the case may be, the heirs of the body [fol. 80] of my said daughter, and in the absence of such heirs of the body, to the personal representative of my daughter's estate to be disposed of according to law.

ARTICLE III.

In the administration and distribution of the Trust Estate hereinabove created, the Trustees and any persons who are or may become beneficiaries under said Article shall be governed and controlled by the following:

- (a) The Trustees may cause the investments which may be delivered to or acquired by them to be registered in their names or in the name of their nominee.
- (b) Any assets now or hereafter transferred to the Trustees or acquired by them as Trustees hereunder, may be held and retained by them in the Trust Estate in their sole discretion, whether or not the same conform to the laws applicable to the investment of trust funds.
- (c) The Trustees, insofar as possible, shall invest and reinvest all funds from time to time available for investment or reinvestment in stocks, bonds, negotiable instruments and other securities and investments as the Trustees, in their discretion, shall deem proper and for the best interests of the Trust Estate without being restricted by any present or

future laws governing the investment of trust funds. The Trustees, for any consideration or purpose which they shall deem proper, may sell, exchange, alter, mortgage or pledge the investments of the Trust Estate, or any of them, may join in by deposit, pledge or otherwise any plan of reorganization or readjustment of any corporation, or use any other means of protecting or dealing with any investment of the Trust Estate, and in general may exercise each and every other power or right with respect to the ownership of each investment of the Trust Estate as individuals generally have and enjoy with respect to their own investments and securities including the power to issue any and all proxies, to vote stock and to deposit securities with any bondholder's protective committee. In the investment or disposition of any property in said trust, the Trustees are permitted to deal with any one of the Trustees individually, being restricted in such dealing only to the fair market value of the property involved. The Trustees shall have full power of collection, satisfaction, enforcement, extension, settlement, composition, compromise, assignment, transfer and conveyance of and over any and all the assets from time to time subsisting in the Trust Estate. They may in their discretion and at their risk transfer to and carry [fol. 81] in their individual names, or in the name of a nominee, any assets of the Trust Estate.

- (d) No purchaser at any sale by the Trustees hereunder, nor any person dealing with them, shall be privileged or required to inquire into any act of the Trustees hereunder, nor obliged to see to the application of any money or property paid or delivered to the Trustees.
- (e) The Trustees are hereby vested with full right, power and authority to determine the manner in which expenses are to be borne and the manner in which receipts are to be credited as between principal and income, and also to determine what shall be "income" and "net income". The Trustees are

authorized, in their sole discretion, to charge all premiums on investments forthwith against principal and to credit all discounts thereon to principal instead of against or to income.

- (f) All payments of income and/or distributions of principal as and when such payments or distributions become due shall be made to the beneficiary in person, or upon her personal receipt, and shall not be grantable, transferable or otherwise assignable in anticipation of payment thereof, in whole or in part, by the voluntary or involuntary acts of such beneficiary or by operation of law and shall not be liable or taken for any obligation of the beneficiary, including alimony. Distributions of the Trust Estate may be made in investments and/or cash and in such proportions thereof as the Trustees shall determine to be most equitable.
- (g) The Trustees shall pay all costs, charges and expenses of the management of the Trust Estate and all taxes assessed on or against the Trust Estate or the Trustees on account of the Trust Estate, together with reasonable compensation to the Trustees for their services hereunder. All income taxes which may be assessed on or against the Trust Estate or the Trustees on account of the Trust Estate by reason of any profit derived from the sale of securities or by reason of stock dividends declared on any shares of stock constituting a part of the Trust Estate shall be paid therefrom.
- (h) If, at any time, any investment of the Trust Estate shall consist of real estate, then in addition to the powers hereinbefore conferred upon the Trustees, the Trustees may, for any consideration or purpose which they shall deem proper, lease such real estate for any term of years, although such term of years shall extend beyond the period of this [fol. 82] trust, and may make alterations or repairs on, additions to and erect or raze improvements on such real estate. They may also pay out of the Trust Estate all taxes and special assessments lev-

ied or imposed upon or against any such real estate, and also the necessary and usual charges and expenses in connection with the management, operation and control and sale thereof. Real Estate may be sold in the Trustees' discretion on any terms deemed suitable and sales may be made partly for cash and the balance on credit.

- (i) In each case where discretionary power is vested in the Trustees hereunder, their exercise thereof shall be final and conclusive and binding upon all persons having any rights under this Trust Agreement.

The powers enumerated above are not intended and shall not be construed in any respect as in limitation of any authority given or conferred upon the Trustees by law, but are intended and shall be construed as in addition thereto.

The Trustees may, in any case, act without the giving of any bond or other security for the faithful performance of their duties, and shall be personally liable only in the event of bad faith in the performance of their duties.

In the event of the death of either or both of the Trustees, PETER G. FARROW or MARY L. SCHICK, or in the event of the resignation, removal or refusal to act of any one or more of the Trustees, then and in either of those events the remaining Trustee or Trustees shall continue the administration of the Trust Estate, shall be vested with title to all of the property included in the Trust Estate, and shall have and exercise all of the rights, privileges and powers, whether discretionary or otherwise, which are by this Instrument vested in the original Trustees.

IN WITNESS WHEREOF the Settlor has hereunto set his hand and seal, and said EDWARD H. FABRICE, PETER G. FARROW and MARY L. SCHICK, the Trustees, have hereunto set their hands and seals to evidence their acceptance of the trusts hereby imposed.

This Trust Agreement is executed in triplicate.

..... (SEAL)
Settlor

..... (SEAL)
Trustee

..... (SEAL)
Trustee

..... (SEAL)
Trustee

[fols. 84-89] * * *

[fol. 90]

WFC:MH 1/8/37 1&4

EXHIBIT "C" TO STIPULATION

THIS INDENTURE OF TRUST, made and executed this 20th day of January, A. D. 1937, by EDWARD H. FABRICE of the City of Chicago, County of Cook and State of Illinois, hereinafter sometimes called the "Settlor", WITNESSETH:

That the Settlor, in consideration of the agreements and undertakings hereinafter made by the Trustees, does hereby sell, assign, transfer and set-over unto the Trustees the following described securities to-wit:

One hundred one (101) shares of the capital stock of Fabart Instrument Company, an Illinois Corporation, and the Trustees are hereby authorized to and agree that they will receive and hold the said securities and/or such additional securities, cash and real estate or other property as may be transferred, assigned, conveyed, bequeathed, devised or delivered to the Trustees by the Settlor, or by any person, to become a part of the principal of the Trust Estate, and all investments and reinvestments thereof, hereinafter sometimes called the "Trust Estate", and the income therefrom, for the uses and purposes and upon the terms and conditions hereinafter provided, that is to say:

ARTICLE I.

This agreement and the trust hereby evidenced shall be known as and designated as: "THE EDWARD H. FABRICE—JANET FABRICE TRUST #2".

ARTICLE II.

The Trust Estate shall be distributed both as to income and principal in the following manner:

[fol. 91] (a) The net income from the Trust Estate shall be paid, in whole or in part, to my daughter, JANET FABRICE, in such proportions, amounts and at such times as the Trustees may, from time

to time, in their sole discretion, determine, or said net income may be retained by the Trustees and credited to the account of said beneficiary, and any income not distributed in any calendar year shall become a part of the principal of the Trust Estate.

- (b) The Trustees may, in their sole discretion, instead of paying said income to said beneficiary or applying the same to the account of said beneficiary, use said income for the proper and suitable support and maintenance of said beneficiary and any persons who may be dependent upon her for support in such manner as Trustees may determine.
- (c) If, because of accident, sickness or other emergency or unusual condition of any kind, the Settlor's said daughter, or any of the daughter's children, shall be in need of funds in addition to the income received by her from all sources within the knowledge of the Trustees, or if the Settlor's said daughter, or any of her children, shall be in need of extra funds for the purpose of providing for the education of the said daughter's children, or any of them, then the Trustees upon the written request of the Settlor's daughter, or any of her children being in need, may withdraw from the principal of the Trust Estate and pay unto the Settlor's said daughter for her own use and benefit, or for that of the daughter's children, or any of them, such sum or sums, at any time and from time to time, as in the absolute opinion of the Trustees shall be reasonably sufficient to relieve their need.
- (d) This Trust may not be revoked or altered by the Settlor, but shall terminate upon the happening of any one of the following contingencies:

- (1) At the expiration of twenty-five (25) years from and after the date of this Instrument;

or

- (2) At the expiration of twenty-one (21) years from and after the death of my said daughter, JANET FABRICE;

whichever contingency shall occur first.

- (e) In the event the Trust terminates by reason of lapse of time as provided in Article II, (d), (1) above, all property included in the Trust Estate shall be immediately distributed to my daughter, JANET FABRICE, if she be then living, and if [fol. 92] not then living to her then living descendants per stirpes and not per capita, and in the absence of such descendants to the then living descendants of the Settlor per stirpes and not per capita. In the event the Trust shall terminate by reason of lapse of time, as provided in Article II, (d), (2) above, all property included in the Trust shall be immediately distributed to the then living descendants of my said daughter, JANET FABRICE, per stirpes and not per capita, and in the absence of such descendants to the then living descendants of the Settlor per stirpes and not per capita.
- (f) In the event of the death of my said daughter, JANET FABRICE, prior to the time herein fixed for distribution of the principal of the Trust Estate, the Trustees shall pay the income therefrom to, or use the same in whatsoever manner they deem advisable for the benefit of, the descendants of said daughter, and if none then the descendants of the Settlor. Such income shall be paid to or used for the benefit of such descendants per stirpes and not per capita.

ARTICLE III.

In the administration and distribution of the Trust Estate hereinabove created, the Trustees and any persons who are or may become beneficiaries under said Article shall be governed and controlled by the following:

- (a) The Trustees may cause the investments which may be delivered to or acquired by them to be registered in their names or in the name of their nominee.
- (b) Any assets now or hereafter transferred to the Trustees or acquired by them as Trustees hereunder, may be held and retained by them in the Trust

Estate in their sole discretion, whether or not the same conform to the laws applicable to the investment of trust funds.

- (c) The Trustee, insofar as possible, shall invest and reinvest all funds from time to time available for investment or reinvestment in stocks, bonds, negotiable instruments and other securities and investments as the Trustees, in their discretion, shall deem proper and for the best interests of the Trust Estate without being restricted by any present or future laws governing the investment of trust funds. The Trustees, for any consideration or purpose which they shall deem proper, may sell, exchange, alter, mortgage or pledge the investments of the Trust Estate, or any of them, may join in by [fol. 93] deposit, pledge or otherwise any plan of reorganization or readjustment of any corporation, or use any other means of protecting or dealing with any investment of the Trust Estate, and in general may exercise each and every other power or right with respect to the ownership of each investment of the Trust Estate as individuals generally have and enjoy with respect to their own investments and securities including the power to issue any and all proxies, to vote stock and to deposit securities with any bondholder's protective committee. In the investment or disposition of any property in said trust, the Trustees are permitted to deal with any one of the Trustees individually, being restricted in such dealing only to the fair market value of the property involved. The Trustees shall have full power of collection, satisfaction, enforcement, extension, settlement, composition, compromise, assignment, transfer and conveyance of and over any and all the assets from time to time subsisting in the Trust Estate. They may in their discretion and at their risk transfer to and carry in their individual names, or in the name of a nominee, any assets of the Trust Estate.
- (d) No purchaser at any sale by the Trustees hereunder, nor any person dealing with them shall be

privileged or required to inquire into any act of the Trustees hereunder, nor obliged to see to the application of any money or property paid or delivered to the Trustees.

- (e) The Trustees are hereby vested with full right, power and authority to determine the manner in which expenses are to be borne and the manner in which receipts are to be credited as between principal and income, and also to determine what shall be "income" and "net income". The Trustees are authorized, in their sole discretion, to charge all premiums on investments forthwith against principal and to credit all discounts thereon to principal instead of against or to income.
 - (f) All payments of income and/or distributions of principal as and when such payments or distributions become due shall be made to the beneficiary in person, or upon her personal receipt, and shall not be grantable, transferable or otherwise assignable in anticipation of payment thereof, in whole or in part, by the voluntary or involuntary acts of such beneficiary or by operation of law and shall not be liable or taken for any obligation of the beneficiary, including alimony. Distributions of the Trust Estate may be made in investments and/or cash and in such proportions thereof as the Trustees shall determine to be most equitable.
- [fol. 94] (g) The Trustees shall pay all costs, charges and expenses of the management of the Trust Estate and all taxes assessed on or against the Trust Estate or the Trustees on account of the Trust Estate, together with reasonable compensation to the Trustees for their services hereunder. All income taxes which may be assessed on or against the Trust Estate or the Trustees on account of the Trust Estate by reason of any profit derived from the sale of securities or by reason of stock dividends declared on any shares of stock constituting a part of the Trust Estate shall be paid therefrom.
- (h) If, at any time, any investment of the Trust Estate shall consist of real estate, then in addition to

the powers hereinbefore conferred upon the Trustees, the Trustees may, for any consideration or purpose which they shall deem proper, lease such real estate for any term of years, although such term of years shall extend beyond the period of this trust, and may make alterations or repairs on, additions to and erect or raze improvements on such real estate. They may also pay out of the Trust Estate all taxes and special assessments levied or imposed upon or against any such real estate, and also the necessary and usual charges and expenses in connection with the management, operation and control and sale thereof. Real Estate may be sold in the Trustees' discretion on any terms deemed suitable and sales may be made partly for cash and the balance on credit.

- (i) In each case where discretionary power is vested in the Trustees hereunder, their exercise thereof shall be final and conclusive and binding upon all persons having any rights under this Trust Agreement.

The powers enumerated above are not intended and shall not be construed in any respect as in limitation of any authority given or conferred upon the Trustees by law, but are intended and shall be construed as in addition thereto.

All of the foregoing powers of the Trustees are subject to the express limitation that, so long as the Settlor lives and remains competent, the Trustees shall not sell or otherwise dispose of any assets of the Trust Estate except upon his written direction to that effect, and the Settlor, for himself and for all the beneficiaries hereunder, hereby expressly releases and exonerates the Trustees of and from any and all liability on account of or arising out of the retention of any assets of the Trust Estate.

[fol. 95] The Trustees may, in any case, act without the giving of any bond or other security for the faithful performance of their duties, and shall be personally liable only in the event of bad faith in the performance of their duties.

In the event of the death, resignation, removal or refusal to act of any one or more of the Trustees, then and in either of those events the remaining Trustee or Trustees shall continue the administration of the Trust Estate, shall be vested with title to all of the property included in the Trust Estate, and shall have and exercise all of the rights, privileges and powers, whether discretionary or otherwise, which are by this Instrument vested in the original Trustees.

IN WITNESS WHEREOF the Settlor has hereunto set his hand and seal, and said EDWARD H. FABRICE, PETER G. FARROW and MARY L. SCHICK, the Trustees, have hereunto set their hands and seals to evidence their acceptance of the trusts hereby imposed.

This Trust Agreement is executed in triplicate.

..... (SEAL)

Settlor

..... (SEAL)

Trustee

..... (SEAL)

Trustee

..... (SEAL)

Trustee

[fol. 102]

WFC:MH 1/8/37 1&4

EXHIBIT E TO STIPULATION

THIS INDENTURE OF TRUST, made and executed this 20th day of January, A. D. 1937, by EDWARD H. FABRICE of the City of Chicago, County of Cook and State of Illinois, hereinafter sometimes called the "Settlor", WITNESSETH:

That the Settlor, in consideration of the agreements and undertakings hereinafter made by the Trustees, does hereby sell, assign, transfer and set-over unto the Trustees the following described securities to-wit:

One hundred one (101) shares of the capital stock of Fabart Instrument Company, an Illinois Corporation, and the Trustees are hereby authorized to and agree that they will receive and hold the said securities and/or such additional securities, cash and real estate or other property as may be transferred, assigned, conveyed, bequeathed, devised or delivered to the Trustees by the Settlor, or by any person, to become a part of the principal of the Trust Estate, and all investments and reinvestments thereof, hereinafter sometimes called the "Trust Estate", and the income therefrom, for the uses and purposes and upon the terms and conditions hereinafter provided, that is to say:

ARTICLE I.

This agreement and the trust hereby evidenced shall be known as and designated as: "THE EDWARD H. FABRICE—MARTHA G. FABRICE TRUST".

ARTICLE II.

The Trust Estate shall be distributed both as to income and principal in the following manner:

[fol. 103] (a) The net income from the Trust Estate shall be paid, in whole or in part, to my wife,

MARTHA G. FABRICE, in such proportions, amounts and at such times as the Trustees may, from time to time, in their sole discretion, determine, or said net income may be retained by the Trustees and credited to the account of said beneficiary, and any income not distributed in any calendar year shall become a part of the principal of the Trust Estate.

- (b) The Trustees may, in their sole discretion, instead of paying said income to said beneficiary or applying the same to the account of said beneficiary, use said income for the proper and suitable support and maintenance of said beneficiary and any persons who may be dependent upon her for support in such manner as the Trustees may determine.
- (c) If, because of accident, sickness or other emergency or unusual condition of any kind, the Settlor's said wife shall be in need of funds in addition to the income received by her from all sources within the knowledge of the Trustees, then the Trustees, upon the written request of the Settlor's wife, may withdraw from the principal of the Trust Estate and pay unto the Settlor's said wife for her own use and benefit, such sum or sums, at any time and from time to time, as in the absolute opinion of the Trustees shall be reasonably sufficient to relieve her need.
- (d) This Trust may not be revoked or altered by the Settlor, but shall terminate upon the happening of any one of the following contingencies:

- (1) At the expiration of twenty-five (25) years from and after the date of this Instrument;

or

- (2) At the expiration of twenty-one (21) years from and after the death of my said wife, MARTHA G. FABRICE;

whichever contingency shall occur first.

- (e) In the event the Trust terminates by reason of lapse of time as provided in Article II, (d), (1)

above, all property included in the Trust Estate shall be immediately distributed to my wife, MARTHA G. FABRICE, if she be then living, and if not then living to her then living descendants per stirpes and not per capita, and in the absence of such descendants then to the personal representatives of her estate to be disposed of according to law. In the event the Trust shall terminate by reason of lapse of time, as provided in Article II, [fol. 104] (d), (2) above, all property included in the Trust shall be immediately distributed to the then living descendants of my said wife, MARTHA G. FABRICE, per stirpes and not per capita, and in the absence of such descendants then to the personal representatives of her estate to be disposed of according to law.

- (f) In the event of the death of my said wife, MARTHA G. FABRICE, prior to the time herein fixed for distribution of the principal of the Trust Estate, the Trustees shall pay the income therefrom to, or use the same in whatsoever manner they deem advisable for the benefit of, the descendants of my said wife, per stirpes and not per capita, and if none, then the same shall be paid to the personal representatives of her estate to be disposed of according to law.

ARTICLE III.

In the administration and distribution of the Trust Estate hereinabove created, the Trustees and any persons who are or may become beneficiaries under said Article shall be governed and controlled by the following:

- (a) The Trustees may cause the investments which may be delivered to or acquired by them to be registered in their names or in the name of their nominee.
- (b) Any assets now or hereafter transferred to the Trustees or acquired by them as Trustees hereunder, may be held and retained by them in the Trust Estate in their sole discretion, whether or not the

same conform to the laws applicable to the investment of trust funds.

- (c) The Trustees, insofar as possible, shall invest and reinvest all funds from time to time available for investment or reinvestment in stocks, bonds, negotiable instruments and other securities and investments as the Trustees, in their discretion, shall deem proper and for the best interests of the Trust Estate without being restricted by any present or future laws governing the investment of trust funds. The Trustees, for any consideration or purpose which they shall deem proper, may sell, exchange, alter, mortgage or pledge the investments of the Trust Estate, or any of them, may join in by deposit, pledge or otherwise any plan of reorganization or readjustment of any corporation, or use any other means of protecting or dealing with any investment of the Trust Estate, and in general may exercise each and every other power or right with respect to the ownership of each investment of the Trust Estate as individuals generally have and enjoy with respect to their own investments and securities including the power to issue any and all proxies, to vote stock and to deposit securities with any bondholder's protective committee. In the investment or disposition of any property in said trust, the Trustees are permitted to deal with any one of the Trustees individually, being restricted in such dealing only to the fair market value of the property involved. The Trustees shall have full power of collection, satisfaction, enforcement, extension, settlement, composition, compromise, assignment, transfer and conveyance of and over any and all the assets from time to time subsisting in the Trust Estate. They may in their discretion and at their risk transfer to and carry in their individual names, or in the name of a nominee, any assets of the Trust Estate.
- (d) No purchaser at any sale by the Trustees hereunder, nor any person dealing with them shall be privileged or required to inquire into any act of the

Trustees hereunder, nor obliged to see to the application of any money or property paid or delivered to the Trustees.

- (e) The Trustees are hereby vested with full right, power and authority to determine the manner in which expenses are to be borne and the manner in which receipts are to be credited as between principal and income, and also to determine what shall be "income" and "net income". The Trustees are authorized, in their sole discretion, to charge all premiums on investments forthwith against principal and to credit all discounts thereon to principal instead of against or to income.
- (f) All payments of income and/or distributions of principal as and when such payments or distributions become due shall be made to the beneficiary in person, or upon her personal receipt, and shall not be grantable, transferable or otherwise assignable in anticipation of payment thereof, in whole or in part, by the voluntary or involuntary acts of such beneficiary or by operation of law and shall not be liable or taken for any obligation of the beneficiary, including alimony. Distributions of the Trust Estate may be made in investments and/or cash and in such proportions thereof as the Trustees shall determine to be most equitable.
- (g) The Trustees shall pay all costs, charges and expenses of the management of the Trust Estate and all taxes assessed on or against the Trust Estate or the Trustees on account of the Trust Estate, together with reasonable compensation to the Trustees for their services hereunder. All income [fol. 106] taxes which may be assessed on or against the Trust Estate or the Trustees on account of the Trust Estate by reason of any profit derived from the sale of securities or by reason of stock dividends declared on any shares of stock constituting a part of the Trust Estate shall be paid therefrom.
- (h) If, at any time, any investment of the Trust Estate shall consist of real estate, then in addition to the powers hereinbefore conferred upon the Trus-

tees, the Trustees may, for any consideration or purpose which they shall deem proper, lease such real estate for any term of years, although such term of years shall extend beyond the period of this trust, and may make alterations or repairs on, additions to and erect or raze improvements on such real estate. They may also pay out of the Trust Estate all taxes and special assessments levied or imposed upon or against any such real estate, and also the necessary and usual charges and expenses in connection with the management, operation and control and sale thereof. Real Estate may be sold in the Trustees' discretion on any term deemed suitable and sales may be made partly for cash and the balance on credit.

- (i) In each case where discretionary power is vested in the Trustees hereunder, their exercise thereof shall be final and conclusive and binding upon all persons having any rights under this Trust Agreement.

The powers enumerated above are not intended and shall not be construed in any respect as in limitation of any authority given or conferred upon the Trustees by law, but are intended and shall be construed as in addition thereto.

All of the foregoing powers of the Trustees are subject to the express limitation that, so long as the Settlor lives and remains competent, the Trustees shall not sell or otherwise dispose of any assets of the Trust Estate except upon his written direction to that effect, and the Settlor, for himself and for all the beneficiaries hereunder, hereby expressly releases and exonerates the Trustees of and from any and all liability on account of or arising out of retention of any assets of the Trust Estate.

[fol. 107] The Trustees may, in any case, act without the giving of any bond or other security for the faithful performance of their duties, and shall be personally liable only in the event of bad faith in the performance of their duties.

In the event of the death, resignation, removal or refusal to act of any one or more of the Trustees, then and in either of those events the remaining Trustee or Trustees shall continue the administration of the Trust Estate, shall be vested with title to all of the property included in the Trust Estate, and shall have and exercise all of the rights, privileges and powers, whether discretionary or otherwise or otherwise, which are by this Instrument vested in the original Trustees.

IN WITNESS WHEREOF the Settlor has hereunto set his hand and seal, and said EDWARD H. FABRICE, PETER G. FARROW and MARY L. SCHICK, the Trustees, have hereunto set their hands and seals to evidence their acceptance of the trusts hereby imposed.

This Trust Agreement is executed in triplicate.

..... (SEAL)
Settlor

..... (SEAL)
Trustee

..... (SEAL)
Trustee

..... (SEAL)
Trustee

[fols. 108-200] * * *

[fol. 201]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 58 C 76

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER
G. FARROW, as Executors of the Will of Edward H.
Fabrice, Deceased, PLAINTIFFS

vs.

THE UNITED STATES OF AMERICA, DEFENDANT

MEMORANDUM, FINDINGS OF FACT, CONCLUSIONS OF LAW
AND ORDER—August 2, 1963

Edward H. Fabrice (hereinafter referred to as "Fabrice") died a resident of Illinois on October 13, 1949. Prior to his death Fabrice had created five irrevocable trusts naming himself and two other persons as co-trustees. The trust instruments were identical except for the names of the beneficiaries and the property transferred. Fabrice's daughter Janet was the beneficiary of two of the trusts, his daughter Lorraine was beneficiary of two others and his wife was to receive the benefit from the fifth trust.

During his lifetime Fabrice orally leased, occupied and paid rent to his daughters for three Wisconsin farms beneficially owned by them. The daughters owned the farms by virtue of conveyances made to them by Fabrice. As a tenant Fabrice erected certain buildings and other improvements on the farms, for which he took depreciation deductions on his federal income tax returns.

After the death of Fabrice and the filing of his federal estate tax return, the Commissioner of Internal Revenue determined his estate tax liability should have been \$80,-726.36. The estate tax return having showed no such tax [fol. 202] due, a deficiency of \$80,726.36 was assessed. The items added to Fabrice's gross estate by the Commissioner were as follows:

(a) *Janet Fabrice Trust No. 1*

75 shares of Fabart Company
stock given to the trust by
Fabrice

112 shares of Fabart Company
stock purchased by the trust

187 shares at \$200 each.....	\$37,400.00	
Cash	805.29	\$38,205.29

(b) *Lorraine Fabrice Trust No. 1*

75 shares of Fabart Company
stock given to the trust by
Fabrice

112 shares of Fabart Company
stock purchased by the trust

187 shares at \$200 each.....	\$37,400.00	
Cash	7,615.95	\$45,015.95

(c) *Janet Fabrice Trust No. 2*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of Fabart Company
stock purchased by the trust

253 shares at \$200 each.....	\$50,600.00	
Cash	12,987.72	\$63,587.72

(d) *Lorraine Fabrice Trust No. 2*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of Fabart Company
stock purchased by the trust

253 shares at \$200 each.....	\$50,600.00	
Cash	12,597.35	\$63,197.35

(e) *Martha G. Fabrice Trust*

101 shares of Fabart Company
stock given to the trust by
Fabrice

152 shares of Fabart Company
stock purchased by the trust

253 shares at \$200 each.....	\$50,600.00	
Cash	16,134.85	\$66,734.85

[fol. 203]

(f) Farm Improvements	\$ 37,000.00
	<hr/>
	\$313,741.16

Of the \$313,741.16 added by the defendant to Fabrice's gross estate, \$186,141.16 represents property acquired by the trustees from income generated by the trusts subsequent to their creation.

In August 1954 plaintiffs paid to the Director of Internal Revenue the amount of the claimed deficiency together with interest of \$16,774.49, or a total of \$97,500.85. In August 1956 plaintiffs filed a claim for refund of the \$97,500.85 with interest thereon. The District Director disallowed this claim in April 1957, whereupon in May 1957 plaintiffs filed a protest. In September 1957 the Office of the Regional Commissioner sent to plaintiffs a notice of formal disallowance of their claim.

Three separate questions are presented by the above facts: (1) Was Fabrice's right, as a co-trustee, to distribute or accumulate income of the trusts governed by a definite external standard and thus not a power to designate the persons who would possess or enjoy the income as set forth in Title 26, U.S.C. § 811 (c) (1) (B) (ii) and (d) (1)? (2) Is income derived from the transferred property subsequent to the transfer excludable from the above mentioned statutes? (3) Did Fabrice maintain "possession or enjoyment" of the farm improvements as contemplated by Title 26 U.S.C. § 811 (c) (1) (B) (i)?

I now consider the first issue; whether Fabrice's power to distribute or accumulate the income of the trust brought the trust within the terms of § 811 (c) (1) (B) (ii) and/or (D) (1).

Paragraph (a) of Article II of each of the five trusts vests in Fabrice the power to distribute or accumulate the [fol. 204] income of the trusts. The Article and Paragraph provide:

Article II

"The trust estate shall be distributed both as to income and principal in the following manner:

(a) The net income from the Trust Estate shall be paid, in whole or in part, to my (herein the beneficiary was named), in such proportions, amounts and at such times as the trustees may, from time to time, in their sole discretion, determine, or said net income may be retained by the trustees and credited to the account of said beneficiary, and any income not distributed in any calendar year shall become a part of the principal of the Trust Estate."

It is the contention of the Government that the language above had the effect of permitting the settlor, Fabrice, to designate the persons who would enjoy the income and to alter the trust within the meaning of § 811, (c) (1) (B) and (d) (1) of the Internal Revenue Code of 1939. This statute provides what property shall be included in a decedent's gross estate. As far as material here paragraph (c) [as amended by Section 7 (a) of the Act of October 25, 1949, c.720, 63 Stat. 891] relating to transfers in contemplation of, or taking effect at death, provides:

(1) *General Rule.* To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

Paragraph (d) relating to revocable transfers provides:

[fol. 205] (1) *Transfers after June 22, 1936.* To the extent of any interest therein of which the decedent

has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

The government's basic contention is supported by *Industrial Trust Co. v. Commissioner*, 165 F. 2d 142 wherein the Court of Appeals for the First Circuit affirmed (and in part reversed and remanded but on other grounds), a Tax Court decision reported as *Estate of Budlong v. Commissioner* 7, T.C. 756, and 8 T.C. 284. The Tax Court had held that the power reserved by a decedent, as trustee, to accumulate or distribute the income at his discretion, amounted to a power to designate the persons who should possess or enjoy income within the meaning of § 811 (c), and as such was includable in the gross estate. Further, in construing § 811 (d), the Supreme Court in *Estate of Holmes v. Commissioner* 326 U.S. 480 at 487 stated:

"It seems obvious that one who has the power to terminate contingencies upon which the right of enjoyment is staked, so as to make certain that a beneficiary will have it who may never come into it if the power is not exercised, has power which affects not only the time of enjoyment but also the person or persons who may enjoy the donation. More therefore is involved than mere acceleration of the time of enjoyment. The very right of enjoyment is affected, the difference dependent upon the grantor's power being between present substantial benefit and the mere prospect of possibility, even the probability, that one may have it at some uncertain future time or perhaps not at all. A donor who keeps so strong

a hold over the actual and immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which Section 811 (d) (2) requires in order to avoid the tax."

It is obvious that the Court in construing § 811 does not [fol. 206] concern itself with property law relating to vesting of ownership, but, is interested only with who had the actual economic benefit. See also, *Lober v. United States*, 346 U.S. 335.

Plaintiff calls the Court's attention to the case of *Jennings v. Smith*, 161 F. 2d 74. The court in the *Jennings* case held that a right to alter a trust by the exercise of a power to accumulate was not within the ambit of § 811 (d) where such power was circumscribed by a definite external standard. I acknowledge this to be an accurate statement of the law, however, the trust in the *Jennings* case made the power to invade the capital subject to the trustee's determination" . . . that such disbursement is reasonably necessary to enable the beneficiary in question to maintain himself and his family, if any, in comfort and in accordance with the station in life to which he belongs." Also the power to invade the capital was exercisable if the beneficiary or his issue" . . . should suffer prolonged illness or be overtaken by financial misfortune which the trustees deem extraordinary." The wording of the *Jennings* trust make it distinguishable from the *Fabrice* trusts. The wording of the *Fabrice* trusts do not recite definite ascertainable standards restricting the trustees' right to accumulate or distribute. The exercise of this power being left to the unbridled discretion of *Fabrice*, the trusts are absent any perceptible standard.

Moreover, plaintiff's contention that the required external standard is imposed generally by the law of Illinois is without merit. The cases cited by plaintiff clearly set out fundamental principles of trust law: that a trust requires a named beneficiary; that the legal and equitable estates be separated; and, that the trustees owe a fiduciary duty to the beneficiaries. These statements of the law [fol. 207] are not particular to Illinois. Nor do these requirements so circumscribe the trustee's powers in an oth-

erwise unrestricted trust so as to hold such a trust governed by an external standard and thus excludable from the application of § 811 (c) and (d). Thus, the Commissioner of Internal Revenue properly included the trusts in decedent's gross estate.

I now consider the second issue; whether the income derived from the initial trust corpus should be distinguished from the corpus itself, and as such excluded from decedant's gross estate.

This question has been unequivocally decided by our Court of Appeals. In *Commissioner of Internal Revenue v. McDermott's Estate*, 222 Fd 665, the Court had before it a factual situation not unlike the one presently before me. The Court in affirming a Tax Court decision held that accumulated trust income, inasmuch as it was not part of the property transferred at the time of the creation of the trust, should not be included in a decedent's gross estate notwithstanding the proper inclusion of the trust corpus. The *McDermott* decision was recently cited with approval and followed by the 6th Circuit Court of Appeals in *Michigan Trust Co. v. Kavanagh*, 284 F2d 502, (Reversing 171 F. Supp. 227).

Although I am required to follow the conclusions of law stated therein I wish to note my own disagreement with the *McDermott* case. The Court of Appeals in deciding *McDermott* cited and acknowledged their reliance upon *Gidwitz v. Commissioner*, 14 T.C. 1263, affirmed, 196 F2d 813, and *Burns v. Commissioner*, 9 T.C. 979, affirmed, 177 F2d 739. In both *Gidwitz* and *Burns*, the former a 7th Circuit case, the Courts had before them factual situations distinguishable from this and the *McDermott* case. *Gidwitz* and *Burns* concerned themselves with transfers in contemplation of death. (Title 26 U.S.C. § 811 (c).)

The Courts there concluded that decedent's transfer of the property was valid and complete at the time of its [fol. 208] inception, but, that the property transferred, which would not include subsequent income, was, because of the motive of the taxpayer in making the transfer, includable in his gross estate. By contrast, the facts in the *McDermott* case and those presently before me concern themselves with situations wherein the decedent had been

deemed to have retained excessive controls and power over trust property. (Title 26 U.S.C. § 811 (d) (2).) Because of such a retention of benefits the transfer is held to be incomplete until the decedent's death. Accordingly, if the transfer was ineffective then the trust property was properly included in decedent's estate at the time of his death, (this relates back to our first issue), and also the income generated therefrom in my opinion should properly have been included.

But, notwithstanding my own beliefs on this matter, I, in obedience to the law of *stare decisis* and to my duty to follow the law of this Circuit as enunciated by our Court of Appeals, subjectively adhere to the Court's decision in the *McDermott* case. I therefore hold that the Commissioner of Internal Revenue improperly included in decedent's gross estate the sum of \$186,141.16, which sum represents the property acquired by the trustees from income generated by the trusts subsequent to their creation.

I now consider the third issue, whether in placing and maintaining improvements on his leasehold Fabrice can be said to have retained "possession and enjoyment" over the improvements. This question resolves itself on the intended meaning of the terms "possession and enjoyment" as those terms are used in § 811 (c) (1) (B) (i) of Title 26 U.S.C.

The Commissioner of Internal Revenue in determining [fol. 209] Fabrice's estate tax liability added to the gross estate value of the farm improvements. The apparent basis for this determination was the Commissioner's reliance upon the wording of § 811 (c) (1) (B) (i).

I find, that the literal terms of the Statute are clear and unambiguous. In the absence of finding a legislative desire or intention to limit the meaning or interpretation of these terms so as to restrict the application of the Statute, I must apply the Statute as objectively written. Fabrice did retain possession and enjoyment of the improvements for a period which did not end before his death, and accordingly I find the Commissioner properly included the improvements in his estate.

Further, following the law of the *situs* of the property, Wisconsin, these improvements which included farmhouse, garages, barns, silos and various service facilities would

probably be properly classified as trade fixtures. *Old Line Life Insurance Company of America v. Hawn*, 225 Wis. 627. Trade fixtures, as is the case with fixtures *per se*, are property so affixed to the land as to become an integrated part thereof. However, that which a tenant attaches to the land for the purpose of carrying on his business or trade is properly classified as a trade fixture and is treated as an exception to the law relating to fixtures. A recognition of this exception to the law of fixtures is based on a public policy intended to foster trade. A tenant has the right to remove trade fixtures prior to his surrendering possession. This right is subject to the tenant's being liable for injury to the land resulting from the removal. In the above cited *Hawn* decision the Supreme Court of Wisconsin, acknowledging some authority to the contrary, held that public policy encourages the promotion of agriculture as well as any other trade or business [fol. 210] business, and held that houses and equipment erected or brought on a farm by a tenant to further agricultural purposes were trade fixtures. Accordingly, Fabrice's improvements, which he as a tenant brought on the property for agricultural purposes, were trade fixtures. As such they could have been removed by him during his lifetime or by his estate after his death. He did retain possession and enjoyment of the improvements.

In accordance with the above findings the District Director of Internal Revenue is ordered to refund together with interest thereon that portion of plaintiff's deficiency claim payment which was based on the \$186,141.16 of property which resulted from income generated by the trusts subsequent to their creation. Counsel are directed to compute this amount and submit a judgment form within thirty (30) days to the Court for entry.

/s/ Campbell
Chief Judge

Enter: August 2, 1963

/s/ Campbell
Chief Judge

Date: August 2, 1963

[fols. 211-215] * * *

[fol. 216]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Civil No. 58-C-76

CHARLES E. O'MALLEY, CLAUDE G. ALEXANDER and
PETER G. FARROW, as Executors of the Will of Edward
H. Fabrice, Deceased, PLAINTIFFS

v.

THE UNITED STATES OF AMERICA, DEFENDANT

JUDGMENT—October 18, 1963

This action came on for trial before the Court, Honorable William J. Campbell, Chief Judge, presiding, and the issues having been duly tried and a decision having been duly rendered,

It is Ordered and Adjudged that the plaintiffs, Charles E. O'Malley, Claude C. Alexander, and Peter G. Farrow, ex Executors of the Will of Edward H. Fabrice, Deceased, recover of the defendant, The United States of America, the sum of \$76,841.77 with interest thereon as provided by law.

It is further Ordered and Adjudged that this Court hereby retains jurisdiction of this cause for the purpose of redetermining the deduction for attorney's fees and other expenses, if such redetermination is made necessary as a result of any rehearing or appeal.

Dated at Chicago, Illinois, this 18th day of October, 1963.

/s/ Campbell
United States District Judge

[fol. 217] * * *

[fol.218]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[File Endorsement Omitted]

[Title Omitted]

NOTICE OF APPEAL—Filed December 16, 1963

The defendant, United States of America, hereby appeals to the United States Court of Appeals for the Seventh Circuit from the final Order of October 18, 1963 entered by the United States District Court for the Northern District of Illinois, Eastern Division, granting Judgment in favor of the plaintiffs and against the defendant in the above-captioned cause.

The attorneys for the plaintiffs are:

Leon Feldman, Esq.
THOMPSON, RAYMOND, MAYER, JENNER
& BLOOMSTEIN
135 South LaSalle Street
Chicago 3, Illinois

/s/ Frank E. McDonald
FRANK E. McDONALD
United States Attorney

[fol. 219]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

* * * *

No. 14556 September Term, 1964 September Session, 1964

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER
G. FARROW, as Executors of the Will of EDWARD H.
FABRICE, Deceased, PLAINTIFFS-APPELLEES

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.

OPINION—October 27, 1964

Before DUFFY, SCHNACKENBERG and KILEY, *Circuit Judges*.

SCHNACKENBERG, *Circuit Judge*. United States of America, defendant, appeals from a judgment of the district court for \$76,841.77 with interest, against it and in favor of plaintiffs, Charles E. O'Malley, Claude C. Alexander and Peter G. Farrow, as executors of the will of Edward H. Fabrice, deceased.

The stipulated facts reveal that this action is for refund of federal estate tax paid to defendant by plaintiffs, and arises under the Internal Revenue Code of 1939, 26 U.S.C.A., § 1, *et seq.*

Edward H. Fabrice, a resident of Illinois, died on October 13, 1949. In December, 1936, and January, 1937, [fol. 220] Fabrice created five *irrevocable* trusts naming

himself and two other persons as co-trustees. The trust instruments were substantially identical except for the names of the beneficiaries and the property transferred. Fabrice's daughter Janet was the beneficiary of two of the trusts, his daughter Lorraine was beneficiary of two other trusts and his wife was to receive the benefit of the fifth trust.

Under each of the five trusts, the co-trustees retained the right to distribute or accumulate the income of the trusts and the income accumulated was to become part of the principal.

Fabrice retained no power to revoke, change or modify the terms of the trusts for his benefit or in any way by which he could ever acquire any interest in the corpus or income of the trusts.

When Fabrice died in 1949, the total assets in the trusts had a value of \$276,741.16. Shares of stock originally transferred to the trusts had a value of \$90,600. The difference of \$186,141.16 represented the value of accumulated income and stock purchased for the trust with such income. The Commissioner included the total amount of \$276,741.16 in Fabrice's gross estate, on the ground that Fabrice's power to distribute or accumulate the income of the trusts constituted a power to designate the persons who would possess or enjoy the income and to alter the trusts, within the meaning of §§ 811(c) (1) (B) (ii) and 811 (d) (1) of the 1939 Code.

The district court determined that the aforesaid parts of the 1939 Code were applicable, but held that the amount includible in the gross estate was only the value of the stock originally transferred by Fabrice to the trusts (\$90,600) and did not include accumulated income and property purchased with accumulated income (\$186,141.16). It relied on our decision in *Commissioner v. McDermott's Estate*, 222 F. 2d 665 (1965).¹

The parties in this case agree that the judgment entered by the district court conforms with our holding in *McDermott's Estate*. However, defendant asks us to re-[fol. 221] ject *McDermott's Estate* on the authority of

¹ It does not appear that the government applied for a writ of certiorari in *McDermott's Estate*.

Reinecke v. Northern Trust Co., 278 U.S. 339, 345, *Commissioner v. Estate of Church*, 335 U.S. 632, 644-6, and other cases.

After citing our holding in *Commissioner v. Gidwitz*, 196 F.2d 813, we said, in *McDermott's Estate*, at 667-8:

"* * * The accumulations there involved, as in the instant case, were not part of the property transferred and were, therefore, not includible. The Commissioner in his attempt to escape our holding in *Gidwitz* argues that here 'the transfers were not complete until taxpayer's [decendent's] death since the property transferred is includible in his estate by reason of retained powers to designate who shall enjoy, under Code Section 811(c) (1) (B), and to change the enjoyment of the trust estate through a power to alter, amend or revoke, under Code Section 811(d) (1).' We think this attempted distinction is without merit. The transfer in the instant case was as complete as it was in the *Gidwitz* case. The trusts were irrevocable, with no power reserved in the settlor or trustee to revoke, change or modify the terms of the trusts for his benefit or in a manner by which he could ever acquire any interest in either the corpus or the income therefrom. He received the dividends (accumulations) on the trust corpus (corporate stock) solely in his capacity as a trustee. He was without power or right to receive such dividends in any other capacity. The fact that the trustee retained some control over the manner of handling the accumulations and their distribution does not militate against the fact that the transfer of the trust corpus was complete when made. Such control or power as was retained did not or could not result in any financial benefit to the trustee, and neither could it affect the rights of the beneficiaries in the aggregate. It could result in nothing more than the shifting of benefits and a determination as to the time of their enjoyment by the beneficiaries. It is thus our view that the Tax Court properly relied upon the *Gidwitz* case as authority for its position."

We discern that *Commissioner v. Estate of Church* is not inconsistent with *McDermott's Estate*. Church created [fol. 222] an irrevocable trust but required the trustees to pay him the income for life and, under those facts, the Supreme Court held the transfer incomplete until Church's death. In the case at bar, Fabrice had no right to receive the income or corpus during his lifetime or at his death. Nor is *Reinecke* applicable, because the trusts in that case were revocable. *Industrial Trust Co. v. Commissioner*, 1 Cir., 165 F.2d 142 (1947) and other cases relied on by defendant are not inconsistent with the disposition which we make of this appeal. The one exception seems to be *Estate of Round v. Commissioner*, 40 T. C. 970, where the decision does not cite *McDermott's Estate* or the Tax Court's contrary decision in *McDermott's Estate*, 12 TCM 481, 489, or its contrary dictum in *McGehee v. Commissioner*, 28 T.C. 412. These latter decisions cast some doubt upon the authority of *Round*, which was affirmed, 1 Cir., 332 F.2d 590 (1964), in an opinion in which the court admitted, at 595, that it was unable to agree with the Seventh Circuit.

On the other hand, *McDermott's Estate* was approved and followed in *Michigan Trust Company v. Kavanagh*, 6 Cir., 284 F.2d 502 (1960).

Although *McDermott's Estate* was decided in 1955 and the rule stated therein has never been changed by any act of Congress, we believe that it is firmly established as the law of this circuit. Under the doctrine of *stare decisis*, even if we had any doubt as to the correctness of our holding in *McDermott's Estate*, we would not be justified, because of any of the arguments advanced by defendant, in reversing that holding at this time.

In *California State Board v. Goggin*, 9 Cir., 245 F.2d 44 (1957), cert. den. 353 U.S. 961, the court remarked, at 45:

"* * * This Court should respect and follow our previous opinions. The trial courts are entitled to rely upon such earlier pronouncements. * * *"

In *Commissioner of Internal Revenue v. Moran*, 8 Cir., 236 F.2d 595 (1956), at 596, the court said:

“* * * This court has repeatedly held, particularly in tax matters, that the decision of another Court of Appeals should be followed unless demonstrably erroneous or there appear cogent reasons for its rejection. [fol. 223] *Birmingham v. Geer*, 8 Cir., 1950, 185 F.2d 82, 85, certiorari denied 1951, 340 U.S. 951, 71 S.Ct. 571, 95 L. Ed. 686.

‘It is important that, so far as possible and particularly with respect to questions affecting the administration of taxing statutes, there should be uniformity of decision among the circuits. We would not be justified in refusing to follow the decision of the Circuit Court of Appeals in the Avalon case [*Avalon Amusement Corp. v. United States*, 7 Cir., 165 F.2d 653] unless convinced that it was clearly wrong. *United States v. Armature Rewinding Co.*, 8 Cir., 124 F.2d 589, 591; *United States v. Kelley*, 8 Cir., 110 F.2d 922, 924; *Grain Belt Supply Co. v. Commissioner of Internal Revenue*, 8 Cir., 109 F.2d 490, 492.’

“See also *Lazier v. United States*, 8 Cir., 1948, 170 F.2d 521, 526, 9 A.L.R. 2d 324.”

For the reasons which we have herein stated, the judgment from which defendant has appealed is affirmed.

JUDGMENT AFFIRMED.

KILEY, *Circuit Judge*, concurring.

I concur in the result achieved by the majority, because I think the stability of the law in this credit requires that, generally speaking, no panel in this court ought to overrule the decision of another panel, and that only the court *en banc* should exercise this power.

I share the view of the district court, however, which reluctantly followed *McDermott* in its decision, since I have grave doubt about the correctness of the *McDermott*

decision in its reliance upon *Gidwitz*. In the *Gidwitz* case the Tax Court had found as a matter of fact that the transfer was in contemplation of death and accordingly was complete in the transferor's lifetime and thus not includible in his gross estate. There was no reservation by *Gidwitz* of any dominion over the property transferred. *McDermott*, however, as settlor-trustee, reserved the right [fol. 224] to distribute or accumulate income from the trust corpus. Yet this court held that the income was not includible in his gross estate because the transfer was as complete "as it was in the *Gidwitz* case" with no power reserved to "revoke, change or modify" the trust for the settlor's benefit or by which he could ever acquire any interest in the income from the corpus.

This holding was rejected, after analysis, by the First Circuit in *Round v. C.I.R.*, 332 F.2d 590 (1964), and its soundness has been questioned by legal scholars, LOWNDES AND KRAMER, *FEDERAL ESTATE AND GIFT TAXES*, at 434-35 (1962). The views of the First Circuit and of Lowndes and Kramer are support for the Commissioner's contention, in the case before us, that the *Fabrice* transfer, because he reserved dominion over the income until his death, was incomplete until the time of his death. The reservation of dominion over the income in the *McDermott* case and in the case before us is what distinguishes them from *Gidwitz*. The fact that a settlor does not or cannot benefit from the retained power is, in my opinion, immaterial to the precise question here.

* * * *

[fol. 225]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

* * * *

No. 14556

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER
G. FARROW, as Executors of the Will of Edward H.
Fabrice, Deceased, PLAINTIFFS-APPELLEES

vs.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.

JUDGEMENT—October 27, 1964

This cause came on to be heard on the transcript of
the record from the United States District Court for the
Northern District of Illinois, Eastern Division, and was
argued by counsel.

On consideration whereof, it is ordered and adjudged
by this court that the judgment of the said District Court
in this cause appealed from be, and the same is hereby,
AFFIRMED, in accordance with the opinion of this Court
filed this day.

[fol. 226]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

* * * *

No. 14556

Before:

HON. JOHN S. HASTINGS, *Chief Judge*
HON. F. RYAN DUFFY, *Circuit Judge*
HON. ELMER J. SCHNACKENBERG, *Circuit Judge*
HON. WIN G. KNOCH, *Circuit Judge*
HON. LATHAM CASTLE, *Circuit Judge*
HON. ROGER J. KILEY, *Circuit Judge*
HON. LUTHER M. SWYGERT, *Circuit Judge*

CHARLES E. O'MALLEY, ET AL., ETC.,
PLAINTIFFS-APPELLEES

vs.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.

ORDER DENYING PETITION FOR REHEARING EN BANC—
February 8, 1965

IT IS ORDERED by the Court sitting *en banc* that the
petition for rehearing *en banc* filed by appellant herein
be, and the same is hereby DENIED.

(Judges Kiley and Swygert voted to grant a rehearing).

[fol. 227]

UNITED STATES COURT OF APPEALS

[Clerk's Certificate to foregoing Transcript
Omitted in Printing]

[fol. 228]

SUPREME COURT OF THE UNITED STATES

[Title Omitted]

ORDER ALLOWING CERTIORARI—October 11, 1965

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER AND
PETER G. FARROW, AS EXECUTORS OF THE WILL OF
EDWARD H. FABRICE, DECEASED

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SEVENTH CIRCUIT**

The Solicitor General, on behalf of the United States of America, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The memorandum, findings of fact, and conclusions of law of the district court (R. 33-42)¹ are reported at 220 F. Supp. 30. The opinion of the court of appeals (Appendix, *infra*, p. 11) is reported at 340 F. 2d 930.

¹ "R." references are to the appendix to the government's brief in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on October 27, 1964. (Appendix, *infra*, p. 18.) The government's petition for rehearing *en banc* was denied on February 8, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Under Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939 and Section 2036(a)(2) of the Internal Revenue Code of 1954, the gross estate of a decedent includes the value of any property he transferred by *inter vivos* gift, retaining "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." In the present case, the decedent retained the right to designate who would enjoy the income from certain trust property; as co-trustee, he could either pay it out currently to the income beneficiary or accumulate it for the possible benefit of contingent remaindermen. The question presented is whether the amount that is includible in his estate (a) is limited to the value of the property originally transferred to the trusts or (b) also includes the income accumulated in the trusts at the time of his death.

STATUTE INVOLVED

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent

shall be determined by including the value at the time of his death of all property * * *

* * * *

(c) [As amended by Sec. 7(a), Act of October 25, 1949, c. 720, 63 Stat. 894] *Transfers in Contemplation of, or Taking Effect at, Death.*—

(1) *General rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise—

* * * *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; * * *

* * * *

STATEMENT

Edward H. Fabrice died a resident of Illinois on October 13, 1949. Prior to his death, he created five irrevocable trusts naming himself and two other persons as co-trustees. The trust instruments were substantially identical except for the names of the beneficiaries and the property transferred. Fabrice's daughter Janet was the beneficiary of two of the trusts; his daughter Lorraine was the beneficiary of two other trusts; and his wife was to receive the

benefit of the fifth trust. Upon termination, each trust provided for distribution of the trust property to the principal named beneficiary, if living, and to other persons in the event that the principal beneficiary was then deceased. (R. 33.)¹

Under each of the five trusts, Fabrice retained the right (in conjunction with his co-trustees) to distribute or accumulate the income of the trusts, and the income accumulated was to become part of the principal of the trusts. When Fabrice died in 1949, the total assets in the trusts had a value of \$276,741.16. The original shares of stock transferred to the trusts had a value of \$90,600, and the difference of \$186,141.16 represented accumulated income and stock purchased for the trusts with accumulated income. The Commissioner included the total amount of \$276,741.16 in the decedent's gross estate on the ground that the power retained by the decedent—to pay out or accumulate the income of the trusts—constituted a power to designate the persons who would possess or enjoy the income under Section 811(c)(1)(B)(ii) of the 1939 Code.

The district court sustained that determination only in part, holding that the property includible in the decedent's gross estate was limited to the property originally transferred to the trusts (\$90,600) and did

¹ The property in the trusts was payable to the heirs or then living descendants of the income beneficiaries if the latter failed to survive the termination of the trusts (see Exhibits A through E, part of the record on appeal but not reproduced as part of the printed record).

not include the accumulated income and the property purchased with accumulated income (\$186,141.16).³ (R. 39-40.) The court of appeals affirmed. (Appendix, *infra*, p. 18.)

REASONS FOR GRANTING THE WRIT

In its decision below, the Seventh Circuit has reaffirmed its holding in *Commissioner v. McDermott's Estate*, 222 F. 2d 665, a decision which was also relied upon by the Sixth Circuit in *Michigan Trust Company v. Kavanagh*, 284 F. 2d 502. The *McDermott* and *Michigan Trust* decisions were necessarily and explicitly rejected by the First Circuit in *Round v. Commissioner of Internal Revenue*, 332 F. 2d 590.⁴ There is thus a direct conflict between the First Circuit, on the one hand, and the Sixth and Seventh Circuits, on the other hand. The question is of substantial importance to the administration of the federal estate tax, both because provisions for the accumulation of income of a trust at the grantor's discretion are common and because the total amount of income accumulated under such provisions during the grantor's life, often exceeds the value of the property initially transferred.

1. Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, *supra*, pp. 2-3, requires the inclu-

³ The district court itself thought that the gross estate should include the accumulated income as well as the original corpus. It nevertheless considered itself bound to exclude the accumulated income from the gross estate because of a prior decision of the Seventh Circuit, *Commissioner v. McDermott's Estate*, 222 F. 2d 665.

⁴ The taxpayer did not seek Supreme Court review of the decision in *Round*.

sion in the decedent's gross estate of all property he has transferred by *inter vivos* gift, retaining for his lifetime "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." The power retained by the decedent as co-trustee in the instant case, to pay out or accumulate the income of the trusts, is clearly a power to designate the persons who shall possess or enjoy the income from the property within the meaning of Section 811(c)(1) (B)(ii) because, by accumulating the income and adding it to the principal, the settlor is able to shift the enjoyment of the income from the income beneficiary to the ultimate taker of the principal who may not be the income beneficiary.⁵ *Estate of Yawkey v. Commissioner*, 12 T.C. 1164; *Round v. Commissioner*, 332 F. 2d 590 (C.A. 1st), affirming, 40 T.C. 970; *Industrial Trust Co. v. Commissioner*, 165 F. 2d 142 (C.A. 1st). These principles have been recognized and applied by this Court in analogous situations. *Lober v. United States*, 346 U.S. 335; *Commissioner v. Estate of Holmes*, 326 U.S. 480; *Helvering v. City Bank Co.*, 296 U.S. 85; *Porter v. Commissioner*, 288 U.S. 436.

2. The court below accepted these principles in including in decedent's estate the value of the property originally transferred to the trusts (\$90,600). It held, however, that since Section 811(c) dealt only with property which has been the subject of a "transfer" by the decedent, the gross estate did not include the \$186,141 of accumulated income which was added to the trust pursuant to the powers retained by the

⁵ See footnote 2, *supra*.

trustees. It reasoned that, because the settlor had fully disposed of his right personally to enjoy the trust income, he cannot be regarded as having made further transfers when income was accumulated at his direction for the benefit of remaindermen. Appendix, *infra*, pp. 13-14.

We believe that the decision below represents far too narrow an interpretation of the statute. The decedent's failure to reserve for himself any beneficial interest in the income of the trust does not, as the court below recognized, prevent the inclusion in his estate of the property he initially contributed to the trust. By the same token, a relinquishment of any right personally to enjoy the income does not remove from the estate the income accumulated at his direction. In short, if the retention of certain controls over the disposition of the income of a trust is sufficient to justify treating the settlor as the owner of the corpus of the trust, it should certainly be sufficient to treat him as the owner of the accumulated income itself.

This result is dictated by the very theory of the estate tax provisions presently at issue. As the First Circuit noted in *Round v. Commissioner*, 332 F. 2d at pp. 595-596, the corpus of trusts such as those in this case is included in a donor's estate, because the statute treats an *inter vivos* gift of the corpus as an incomplete disposition by the donor so long as he retains the power to control the enjoyment of the income earned by the trust. See *Commissioner v. Estate of Church*, 335 U.S. 632, 644; *Estate of Sanford v. Commissioner*, 308 U.S. 39. Because the statute treats the corpus as still belonging to the donor for purposes of

the estate tax, the transferor remains chargeable with the fruits of investment of that corpus.⁶ His retention of a substantial power over the disposition of future income justifies treating him as the transferor of that income when it arises and he directs that it be accumulated in the trust. And so, the addition to corpus in the form of accumulated income which the settlor "transfers" to the trust is included in his gross estate for the same reason that the court below included the value of the property originally transferred. With regard to the addition to corpus, as with regard to the original corpus, the settlor retains for his life "the right * * * to designate the persons who shall possess * * * the income therefrom."

The Seventh Circuit's decision in *McDermott*, upon which the court relied in deciding the instant case, has been criticized by legal scholars;⁷ its correctness has been questioned by lower courts⁸ and by the concurring opinion in the instant case (Appendix, *infra*, pp. 16-17); and it has been flatly rejected by the First

⁶ A settlor who retains a discretionary power to pay out or accumulate the income of an irrevocable trust makes a transfer for gift-tax purposes whenever he directs the income to be distributed to the income beneficiary or irrevocably accumulated for the benefit of the remainderman. See Lowndes and Kramer, *Federal Estate and Gift Taxes* (1962 ed.), p. 641; Treasury Regulations on Gift Tax (1954 Code), Section 25.2511-2.

⁷ See Lowndes and Kramer, *Federal Estate and Gift Taxes* (1962 ed.), p. 434; Warren and Surrey, *Federal Estate and Gift Taxation* (1961 ed.), p. 608.

⁸ See the district court opinion in the instant case (R. 39-40), and *Michigan Trust Co. v. Kavanagh*, 171 F. Supp. 227 (W.D. Mich.), reversed on appeal, 284 F. 2d 502 (C.A. 6th).

Circuit in the *Round* case. The question involved is important and the conflict should be resolved by this Court.

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for a writ of certiorari should be granted.

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

LORING W. POST,
RALPH A. MUOIO,
Attorneys.

MAY 1965.

APPENDIX

In the United States Court of Appeals for the
Seventh Circuit

No. 14556 September Term, 1964 September Session,
1964

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER AND
PETER G. FARROW, AS EXECUTORS OF THE WILL OF
EDWARD H. FABRICE, DECEASED, PLAINTIFFS-
APPELLEES

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division*

October 27, 1964

Before DUFFY, SCHNACKENBERG and KILEY, *Circuit
Judges.*

SCHNACKENBERG, *Circuit Judge.* United States of
America, defendant, appeals from a judgment of the
district court for \$76,841.77 with interest, against it
and in favor of plaintiffs, Charles E. O'Malley, Claude
C. Alexander and Peter G. Farrow, as executors of
the will of Edward H. Fabrice, deceased.

The stipulated facts reveal that this action is for refund of federal estate tax paid to defendant by plaintiffs, and arises under the Internal Revenue Code of 1939, 26 U.S.C.A., § 1, *et seq.*

Edward H. Fabrice, a resident of Illinois, died on October 13, 1949. In December, 1936, and January, 1937, Fabrice created five *irrevocable* trusts naming himself and two other persons as co-trustees. The trust instruments were substantially identical except for the names of the beneficiaries and the property transferred. Fabrice's daughter Janet was the beneficiary of two of the trusts, his daughter Lorraine was beneficiary of two other trusts and his wife was to receive the benefit of the fifth trust.

Under each of the five trusts, the co-trustees retained the right to distribute or accumulate the income of the trusts and the income accumulated was to become part of the principal.

Fabrice retained no power to revoke, change or modify the terms of the trusts for his benefit or in any way by which he could ever acquire any interest in the corpus or income of the trusts.

When Fabrice died in 1949, the total assets in the trusts had a value of \$276,741.16. Shares of stock originally transferred to the trusts had a value of \$90,600. The difference of \$186,141.16 represented the value of accumulated income and stock purchased for the trust with such income. The Commissioner included the total amount of \$276,741.16 in Fabrice's gross estate, on the ground that Fabrice's power to distribute or accumulate the income of the trusts constituted a power to designate the persons who would possess or enjoy the income and to alter the trusts, within the meaning of §§ 811(c)(1)(B)(ii) and 811(d)(1) of the 1939 Code.

The district court determined that the aforesaid parts of the 1939 Code were applicable, but held that

the amount includible in the gross estate was only the value of the stock originally transferred by Fabrice to the trusts (\$90,600) and did not include accumulated income and property purchased with accumulated income (\$186,141.16). It relied on our decision in *Commissioner v. McDermott's Estate*, 222 F. 2d 665 (1955).¹

The parties in this case agree that the judgment entered by the district court conforms with our holding in *McDermott's Estate*. However, defendant asks us to reject *McDermott's Estate* on the authority of *Reinecke v. Northern Trust Co.*, 278 U.S. 339, 345, *Commissioner v. Estate of Church*, 335 U.S. 632, 644-6, and other cases.

After citing our holding in *Commissioner v. Gidwitz*, 196 F. 2d 813, we said, in *McDermott's Estate*, at 667-8:

"* * * The accumulations there involved, as in the instant case, were not part of the property transferred and were, therefore, not includible. The Commissioner in his attempt to escape our holding in *Gidwitz* argues that here 'the transfers were not complete until taxpayer's [decedent's] death since the property transferred is includible in his estate by reason of retained powers to designate who shall enjoy, under Code Section 811(c)(1)(B), and to change the enjoyment of the trust estate through a power to alter, amend or revoke, under Code Section 811(d)(1).' We think this attempted distinction is without merit. The transfer in the instant case was as complete as it was in the *Gidwitz* case. The trusts were irrevocable, with no power reserved in the settlor or trustee to revoke, change or modify the terms of the trusts for his benefit or in a manner by which he could ever acquire any interest

¹ It does not appear that the government applied for a writ of certiorari in *McDermott's Estate*.

in either the corpus or the income therefrom. He received the dividends (accumulations) on the trust corpus (corporate stock) solely in his capacity as a trustee. He was without power or right to receive such dividends in any other capacity. The fact that the trustee retained some control over the manner of handling the accumulations and their distribution does not militate against the fact that the transfer of the trust corpus was complete when made. Such control or power as was retained did not or could not result in any financial benefit to the trustee, and neither could it affect the rights of the beneficiaries in the aggregate. It could result in nothing more than the shifting of benefits and a determination as to the time of their enjoyment by the beneficiaries. It is thus our view that the Tax Court properly relied upon the *Gidwitz* case as authority for its position."

We discern that *Commissioner v. Estate of Church* is not inconsistent with *McDermott's Estate*. Church created an irrevocable trust but required the trustees to pay him the income for life and, under those facts, the Supreme Court held the transfer incomplete until Church's death. In the case at bar, Fabrice had no right to receive the income or corpus during his lifetime or at his death. Nor is *Reinecke* applicable, because the trusts in that case were *revocable*. *Industrial Trust Co. v. Commissioner*, 1 Cir., 165 F. 2d 142 (1947) and other cases relied on by defendant are not inconsistent with the disposition which we make of this appeal. The one exception seems to be *Estate of Round v. Commissioner*, 40 T.C. 970, where the decision does not cite *McDermott's Estate* or the Tax Court's contrary decision in *McDermott's Estate*, 12 TCM 481, 489, or its contrary dictum in *McGehee v. Commissioner*, 28 T.C. 412. These latter decisions cast some doubt upon the authority of *Round*, which was affirmed, 1 Cir., 332 F. 2d 590 (1964), in an

opinion in which the court admitted, at 595, that it was unable to agree with the Seventh Circuit.

On the other hand, *McDermott's Estate* was approved and followed in *Michigan Trust Company v. Kavanagh*, 6 Cir., 284 F. 2d 502 (1960).

Although *McDermott's Estate* was decided in 1955 and the rule stated therein has never been changed by any act of Congress, we believe that it is firmly established as the law of this circuit. Under the doctrine of *stare decisis*, even if we had any doubt as to the correctness of our holding in *McDermott's Estate*, we would not be justified, because of any of the arguments advanced by defendant, in reversing that holding at this time.

In *California State Board v. Goggin*, 9 Cir., 245 F. 2d 44 (1957), cert. den. 353 U.S. 961, 77 S. Ct. 863, 1 L. Ed. 910, the court remarked, at 45:

“* * * This Court should respect and follow our previous opinions. The trial courts are entitled to rely upon such earlier pronouncements. * * *”

In *Commissioner of Internal Revenue v. Moran*, 8 Cir., 236 F. 2d 595 (1956), at 596, the court said:

“* * * This court has repeatedly held, particularly in tax matters, that the decision of another Court of Appeals should be followed unless demonstrably erroneous or there appear cogent reasons for its rejection. *Birmingham v. Geer*, 8 Cir., 1950, 185 F. 2d 82, 85, certiorari denied 1951, 340 U.S. 951, 71 S. Ct. 571, 95 L. Ed. 686.

“It is important that, so far as possible and particularly with respect to questions affecting the administration of taxing statutes, there should be uniformity of decision among the circuits. We would not be justified in refusing to follow the decision of the Circuit Court of Appeals in the *Avalon* case [*Avalon Amuse-*

ment Corp. v. United States, 7 Cir., 165 F. 2d 653] unless convinced that it was clearly wrong. *United States v. Armature Rewinding Co.*, 8 Cir., 124 F. 2d 589, 591; *United States v. Kelley*, 8 Cir., 110 F. 2d 922, 924; *Grain Belt Supply Co. v. Commissioner of Internal Revenue*, 8 Cir., 109 F. 2d 490, 492."

See also *Lazier v. United States*, 8 Cir., 1948, 170 F. 2d 521, 526, 9 A.L.R. 2d 324.

For the reasons which we have herein stated, the judgment from which defendant has appealed is affirmed.

Judgment Affirmed.

KILEY, *Circuit Judge*, concurring.

I concur in the result achieved by the majority, because I think the stability of the law in this circuit requires that, generally speaking, no panel in this court ought to overrule the decision of another panel, and that only the court *en banc* should exercise this power.

I share the view of the district court, however, which reluctantly followed *McDermott* in its decision, since I have *grave doubt* about the correctness of the *McDermott* decision in its reliance upon *Gidwitz*. In the *Gidwitz* case the Tax Court had found as a matter of fact that the transfer was in contemplation of death and accordingly was complete in the transferor's lifetime and thus not includible in his gross estate. There was no reservation by *Gidwitz* of any dominion over the property transferred. *McDermott*, however, as settlor-trustee, reserved the right to distribute or accumulate income from the trust corpus. Yet this court held that the income was not includible in his gross estate because the transfer was as complete "as it was in the *Gidwitz* case" with no power reserved to

"revoke, change or modify" the trust for the settlor's benefit or by which he could ever acquire any interest in the income from the corpus.

This holding was rejected, after analysis, by the First Circuit in *Round v. C.I.R.*, 332 F. 2d 590 (1964), and its soundness has been questioned by legal scholars, LOWNDES AND KRAMER, FEDERAL ESTATE AND GIFT TAXES, at 434-35 (1962). The views of the First Circuit and of Lowndes and Kramer are support for the Commissioner's contention, in the case before us, that the Fabrice transfer, because he reserved dominion over the income until his death, was incomplete until the time of his death. The reservation of dominion over the income in the *McDermott* case and in the case before us is what distinguishes them from *Gidwitz*. The fact that a settlor does not or cannot benefit from the retained power is, in my opinion, immaterial to the precise question here.

A true Copy:

Teste:

*Clerk of the United States Court of
Appeals for the Seventh Circuit.*

United States Court of Appeals
for the Seventh Circuit

Chicago, Illinois, 60610

Tuesday, October 27, 1964

Before Hon. F. RYAN DUFFY, Circuit Judge; Hon.
ELMER J. SCHNACKENBERG, Circuit Judge; Hon.
ROGER J. KILEY, Circuit Judge

No. 14556

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and
PETER G. FARROW, AS EXECUTORS OF THE WILL OF
EDWARD H. FABRICE, DECEASED, PLAINTIFFS-APPELLEES

vs.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division*

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.



FILE COPY

U.S. Supreme Court, U.S.
FILED

No. [REDACTED] 127 JUN 10 1965

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

UNITED STATES OF AMERICA,

Petitioner,

vs.

CHARLES E. O'MALLEY, CLAUDE G. ALEXANDER and PETER
G. FARROW, as executors of the will of EDWARD E.
FARRICE, deceased,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT
OF HABEAS CORPUS TO THE UNITED STATES COURT
OF APPEALS FOR THE SEVENTH CIRCUIT

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125 South LaSalle Street
Chicago, Illinois 60603

IN THE
Supreme Court of the United States

OCTOBER TERM, 1964

No. 1151

UNITED STATES OF AMERICA,

Petitioner,

VS.

**CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER and PETER
G. FARROW, as executors of the will of EDWARD H.
FABRICE, deceased,**

Respondents.

**BRIEF IN OPPOSITION TO PETITION FOR A WRIT
OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE SEVENTH CIRCUIT**

I.

**An Important Question of Federal Law Is Not Involved
Here**

This case does not involve an important question of federal law which should be settled by the Supreme Court of the United States.

Since 1931, the internal revenue statutes of the United States have contained, in substance, the same provisions of Section 811 of the 1939 Internal Revenue Code which are

in question here. Despite this fact there have been in the ensuing thirty-five years less than a handful of litigated cases which involve, even incidentally, the narrow issue which petitioner seeks to have this Court resolve.

Not only are the cases few in number, but the amount of revenue involved in this type of case must ordinarily be relatively small. The aggregate income likely to be accumulated at the discretion of the trustees from the time a trust is created until the death of the settlor should, as a rule, be far less than the amount of corpus originally transferred to the trust. In *Round v. Commissioner*, 332 F. 2d 590, 592 (C.A. 1st) the accumulated income was substantially less than the corpus, as was the case in *Commissioner v. McDermott's Estate*, 12 TCM 481, aff'd 222 F. 2d 665 (C.A. 7th). This case is unusual in that the accumulated income exceeded the value of the property originally transferred to the trust. This is, in brief, an uncommon case involving a seldom litigated point of tax law.

Nor can it be said that the decision below of the Court of Appeals for the Seventh Circuit opens the way to tax avoidance. Under the facts of this case, Mr. Fabrice, the settlor, created five trusts in which he retained only the power, in conjunction with two co-trustees, to distribute or accumulate the trust income. Fabrice retained no power to revoke, change or modify the terms of the trusts for his own benefit, or in a way by which he could ever acquire any interest in the corpus or income of the trusts. Nevertheless, the retained power concededly made the corpus of the trusts includable in Fabrice's estate. Had Fabrice merely given exclusively to his co-trustees (who could have out-voted him on this point in any event) the retained power to distribute or accumulate income, it would be beyond doubt that neither the value of the accumulated income nor of the corpus would be included in his gross

estate. Under these circumstances, it must be considered a mere fluke that Fabrice retained the costly power to participate in the vote to distribute or accumulate income. Surely this Court should not anticipate that one interested in tax avoidance would deliberately retain so restricted a power if the price is the certain taxability of corpus and the possible taxability of accumulated income. The decision below certainly does not offer a feasible tax avoidance device.

Furthermore, the issue presented by this case is extremely narrow. It requires a definition of the word "transfer" as used in one subsection of the 1939 Internal Revenue Code relating to situations where the settlor of a trust retains one narrow and limited power. Hearing and deciding this case would not enable this Court to establish any important principle to aid in the general enforcement of the tax laws, as did this Court's most recent estate tax case, *Commissioner v. Estate of Noel*, 85 Sup. Ct. 1238 (1965), decided earlier this term.

II.

The Decision Below is Correct

Section 811(c)(1)(B)(ii) of the 1939 Internal Revenue Code includes in a decedent's gross estate the value of all property to the extent of any interest therein of which "the decedent has at any time made a *transfer*". The Court below correctly held that the decedent never "transferred" the accumulated income. To argue, as petitioner does, that the original transfer of corpus was incomplete under the authority of *Commissioner v. Church*, 335 U.S. 632 and *Estate of Sanford v. Commissioner*, 308 U.S. 39, is to misread those decisions. In the former, the settlor was the income beneficiary until his death. In the latter, a gift tax

case, the settlor reserved the right "to modify any or all of the trusts" in any way not beneficial to himself. The Court emphasized that the donee could be made liable for the gift tax but that under the reserved power the identity of the donee could not be ascertained until the settlor's death, 308 U.S. 46. Neither decision fits the facts here.

Moreover, if the transfer is to be deemed incomplete, should not distributed income, as well as accumulated income, logically be caught in petitioner's deep net? That petitioner does not press for this logical extension would indicate that its premise of an "incomplete" transfer is not sound. That premise was, of course, expressly rejected below and petitioner's request for re-hearing *en banc* was denied *en banc* by five of seven judges.

Petitioner states at page 8 of its petition that the Seventh Circuit's *McDermott* decision 222 F.2d 665 has been criticized by legal scholars. The decision has also been approved and more than one writer has cogently urged that the problem is legislative, not judicial. See notes, 54 Michigan Law Review 577, 579; 1955 Univ. of Illinois Law Forum 779, 782; and 51 Northwestern Univ. Law Review 149, 153-154.

CONCLUSION.

It has never been the function of this Court merely to review cases for possible error. Because of its limited time, the Court must hear and decide only those tax cases which involve considerable amounts of revenue or which require the enunciation of general and continuing principles of tax law. This case involves none of these factors and although its narrow issue has been differently decided in

various circuits, that alone does not make this case meet for Supreme Court consideration. Moreover, the decision below is correct.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 127

UNITED STATES OF AMERICA, PETITIONER

v.

CHARLES E. O'MALLEY, CLAUDE C. ALEXANDER AND
PETER G. FARROW, AS EXECUTORS OF THE WILL OF
EDWARD H. FABRICE, DECEASED

*ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum, findings of fact and conclusions of law of the district court (R. 45) are reported at 220 F. Supp. 30. The opinion of the court of appeals (R. 56) is reported at 340 F. 2d 930.

JURISDICTION

The judgment of the court of appeals was entered on October 27, 1964 (R. 62). A timely petition for

rehearing *en banc* was denied on February 8, 1965 (R. 63). The petition for a writ of certiorari was filed on May 10, 1965, and granted on October 11, 1965 (R. 64). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

The decedent established a series of *inter vivos* trusts, retaining, however, the right (in conjunction with his co-trustees) to determine whether to pay out income from each trust currently to the beneficiary or to accumulate the income and add it to the principal of the trust. Because of this retention of rights by the decedent, the original principal is concededly a part of his gross estate for federal estate tax purposes. The question presented is whether the accumulated income held by the trust as of the time of his death should also be included.

STATUTE INVOLVED

Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, as amended (26 U.S.C. 811(c)(1)(B)(ii) (1952 ed.)), provides in pertinent part:

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * * [t]o the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death

* * * the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom * * *.¹

STATEMENT

Edward H. Fabrice died in 1949 (R. 13). Some years before, he had established a series of five irrevocable trusts for the benefit of his wife and daughters. The trust for the wife (R. 38-44) is typical. Three trustees were named, one of them Fabrice (R. 44). The trustees were authorized, in their discretion, to pay out the trust income to the wife currently (R. 39). But they were also authorized, in their discretion, to retain any part of the trust income; and any income not paid out to the wife at the end of each calendar year was to become part of the principal. The trust was to terminate 25 years from the date of the trust instrument or 21 years after the wife's death, whichever occurred first. If the wife was alive when the trust terminated, the principal (including all accumulated income) would go to her; otherwise, it would go to her descendants, or, if none, to her estate (R. 40). The original property of the trust comprised shares in a closely held Illinois corporation (R. 16, 22). The trust income consisted entirely of dividends declared on the stock held by the trust. Some of the trust income was distributed to the wife, but more than half was accumu-

¹ The corresponding provision of Section 2036 of the Internal Revenue Code of 1954, as amended (26 U.S.C. 2036 (1964 ed.)) is materially the same.

lated and used to buy additional shares in the corporation. (R. 22-23).

On Fabrice's death, the principal of the trusts had a value of \$276,741.16, of which \$186,141.16 represented accumulated income, most of which had been used to purchase additional stock in the corporation (R. 15-23, 47, 57). His executors, respondents here, did not include any part of the principal in Fabrice's estate tax return (R. 14, 45). The Commissioner of Internal Revenue determined that the entire value of the trusts should have been included in the return (R. 16, 45-46). Respondents paid the resulting deficiency and brought this action. The district court held (R. 47-51) that Fabrice's taxable estate should include the value on the date of his death of the property he had originally transferred to the trusts—that is, the trust assets less the accumulated income. The court reasoned that Fabrice, by retaining the power (with his co-trustees) to determine whether to pay out or accumulate income, was able "to designate the persons who shall possess or enjoy the property or the income" of the trusts (Section 811(c)(1)(B)(ii), *supra*, pp. 2-3). If the income was paid out currently, the beneficiaries would enjoy it; but to the extent that it was accumulated, it would go to the remaindermen. Respondents did not appeal from this part of the district court's decision, and it is no longer in issue.

On the question whether the accumulated income was also includible in Fabrice's gross estate, the district court agreed (R. 51-52) with the Commissioner that the result should be the same. But noting (R.

51) that the precise question had been "unequivocally decided by our Court of Appeals" against the Commissioner (in *Commissioner v. McDermott's Estate*, 222 F. 2d 665 (C.A. 7)), the district court deemed itself bound to hold for the taxpayer. Declining on the ground of *stare decisis* to re-examine *McDermott*, the court of appeals affirmed (R. 56).²

ARGUMENT

Introduction and Summary

The purpose and method of the federal estate tax is to lay a tax upon the passage of property at death. Accordingly, the property of the decedent at his death—not what he may have given away or otherwise disposed of during his lifetime—is, in the ordinary case, the subject of the tax. But to effectuate this basic policy, it has been deemed necessary to include in the decedent's gross estate for federal estate tax purposes certain property that the decedent, during his lifetime, transferred out of his immediate ownership. In general, Congress has insisted that to escape the estate tax an *inter vivos* transfer must be absolute; the decedent may retain no string over the transferred property. See, e.g., *Commissioner v. Estate of Church*, 335 U.S. 632; *Commissioner v. Estate of Holmes*, 326 U.S. 480; *Reinecke v. Northern Trust*

² *McDermott* was also followed in *Michigan Trust Co. v. Kavanagh*, 284 F. 2d 502 (C.A. 6). But it was rejected in *Round v. Commissioner*, 332 F. 2d 590 (C.A. 1), and has not been followed by the Tax Court (see *Estate of Round v. Commissioner*, 40 T.C. 970, affirmed, 332 F. 2d 590 (C.A. 1)).

Co., 278 U.S. 339. Thus, the Internal Revenue Code makes elaborate provision for transfers which are revocable, or in which the grantor retains a life estate, or reversionary interest, or other rights or interests.³

One form of retained control, explicitly dealt with in Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, is the subject of this case: control over who shall enjoy the income from the property transferred. The district court held—and it is not here in issue—that where, as in the present case, the settlor of a trust retains (whether alone or in conjunction with others, and whether in an individual capacity or as trustee) the right to pay out the trust income to the beneficiary or to accumulate it, the principal of the trust remains a part of the settlor's estate for tax purposes. The reason is that when the settlor decides to accumulate trust income, he shifts enjoyment of the income from the income beneficiary to the remaindermen. See *Lober v. United States*, 346 U.S. 335, 337.

The contested issue at this stage of the case is whether, like the principal, the accumulated income under such a trust is to be included in the settlor's gross estate. We show that the language and scheme of the statute require that it be included. Accumulated income is property over which the settlor retains the same string that makes the original principal includible, and he makes a transfer of such income within the meaning of the statute every time income

³ See 26 U.S.C. 2036-2040 (1964 ed.).

is added to principal at his direction. Thus, the statutory requirements for inclusion in his gross estate are satisfied. We further show that any other result would open a substantial and unjustifiable loophole in the federal estate tax provisions.

THE ADDITION OF INCOME TO THE PRINCIPAL OF THE FABRICE TRUSTS WAS A TRANSFER BY THE SETTLOR OF PROPERTY OVER WHICH HE RETAINED A STRING; HENCE, LIKE THE PRINCIPAL, IT IS SUBJECT TO FEDERAL ESTATE TAX

A. For the accumulated income here to be subject to tax under Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, two conditions must be met: Fabrice must have (1) "made a transfer" of the accumulated income (2) under which he "retained * * * the right * * * to designate the persons who shall possess or enjoy the * * * income therefrom." Certainly, the second of these conditions has been fulfilled. It is conceded that the principal of the Fabrice trusts is subject to federal estate tax by virtue of Fabrice's retention of the power to determine who would enjoy the trust income. Income that the trustees did not pay out was added to, and became a part of, the principal. As such, it produced income which the trustees (just as in the case of any other trust income) were authorized, in their discretion, to pay out or accumulate. Thus, in terms of retention of control, the accumulated income is indistinguishable from the original principal. Since the latter is subject to federal estate tax, so must be the former—if there was a "transfer" of the accumulated income by Fabrice. That is the only real issue.

B. Fabrice reserved in the trust instrument the right to determine enjoyment of the trust income. He exercised this reserved right—and in so doing made a transfer of the accumulated income—every time he determined to retain income in the trust rather than pay it out. When the income arose, it was not yet part of the principal. The trustees could, in their discretion, pay it to the income beneficiary. But they also could, and frequently did, add it to the principal, and its addition to principal was a transfer by the settlor to the trust. We find no basis in the language or policy of the statute for distinguishing a transfer of this kind from any other addition to principal made by the settlor.

The court of appeals reasoned that there was no transfer of the accumulated income by Fabrice because he had no right to its personal enjoyment (R. 58). It was, the court of appeals reasoned, the property of the trusts and not his to transfer. The premise of this reasoning is erroneous. By force of Section 811 (c)(1)(B)(ii), Fabrice's transfer of the original principal to the trustees in trust was, for federal estate tax purposes, incomplete. In contemplation of law, the transfer took effect at his death and all of the property in the trusts was his until he died. The income earned by the trusts was, for federal estate tax purposes, likewise his—just as in the case of any other income from property owned by him. So when he transferred some of the trust income to principal, he was transferring *his* property to the trust. It was

as if he had added to the trust principal additional share of stock that he owned.⁴

To be sure, under ordinary principles of property law Fabrice may not have "owned" either the principal or any of the income of the trusts. But the only concept of ownership relevant here is that of the federal estate tax provisions—under which Fabrice's attempt to divest himself of ownership of the principal by transferring it in trust was concededly ineffectual, and the ownership of the principal, and hence, we submit, of the income therefrom (as it arose) as well, continued in him until his death.

Our contention that an addition of income to principal is a transfer by the settlor within the meaning of Section 811(c)(1)(B)(ii) is supported by the treatment of an analogous problem under the gift-tax provisions of the Internal Revenue Code: a settlor who retains a discretionary power to pay out or accumulate the income of an irrevocable trust makes a transfer for gift-tax purposes whenever he directs the income to be distributed to the income beneficiary or irrevocably accumulated for the benefit of the remainderman. See Lowndes and Kramer, *Federal Estate and Gift Taxes* (1962 ed.), p. 641. It is also

⁴ *Commissioner v. Gidwitz' Estate*, 196 F. 2d 813 (C.A. 7), and *Burns v. Commissioner*, 177 F. 2d 739 (C.A. 5), which held that accumulations of income on property transferred in contemplation of death were not subject to estate tax, are distinguishable. A gift in contemplation of death is complete when made; the donor retains no string. See *United States v. Wells*, 283 U.S. 102, 116-117. Hence, the income from the gift is not his to give. Here, in contrast, the transfer of the principal was incomplete because Fabrice retained a string.

supported by the settled practice of the Internal Revenue Service to value trust assets for estate tax purposes as of the date of death without regard to changes in the trust portfolio made by the trustees.⁵ When trust assets are sold and the proceeds are used to acquire additional assets for the trust, the newly acquired assets are treated as having been transferred to the trust by the settlor. We submit that trust income is similarly transferred when the settlor decides to accumulate it.

In addition, the apparent rationale of the transfer requirements of Section 811(c)(1)(B)(ii) is to exclude from the settlor's gross estate property added to the trust not by him but by a third party. No third party was the source of the additions to principal resulting from the retention of trust income here, and no discernible policy, therefore, would be served by holding—in the teeth of the language and scheme of the statute—that there was no transfer by Fabrice.

C. Not only is the result reached by the court of appeals without basis in the statute; it opens up a substantial loophole. Suppose that the controlling stockholder in a closely held, family corporation desires to avoid a heavy estate tax, but on the other hand does not wish to lose complete control of any substantial part of his property, as he would by

⁵ See *Lober v. United States*, 346 U.S. 335; *Estate of Guggenheim v. Commissioner*, 40 B.T.A. 181, affirmed, 117 F. 2d 469 (C.A. 2), certiorari denied, 314 U.S. 621; *Holderness v. Commissioner*, 33 B.T.A. 155, affirmed, 86 F. 2d 137 (C.A. 4); Montgomery, *Federal Taxes, Estates, Trusts and Gifts* (1951-1952), pp. 626-630.

transferring it outright to members of his family. He therefore establishes a trust and transfers to it most of his stockholdings; but he retains control over the enjoyment of the trust property or income. He cannot, of course, avoid a federal estate tax on the original principal of the trust, because he has not relinquished control over it. But, since the trust is composed of shares in a corporation he controls, he can manipulate the value of the original principal so as to minimize the federal estate tax liability. If during his lifetime the corporation retains most of its earnings, the value of the stock, and hence of the original principal of the trust, will be relatively high at the date of his death; and that will be the value includible in his gross estate. But he need not retain earnings. If, instead, he pays out all of those earnings in the form of dividends,⁶ and then accumulates the trust income, adding it to the principal, the value of the trust will presumably be the same at his death as if the earnings had been retained in the corporation, but under the theory of the court of appeals only a part of it—represented by the original principal—will be subject to federal estate tax. In addition, he can postpone the payment of any dividends until after the trust is established, with the result that the value of the trust when he dies will be represented largely by accumulated income (not subject to estate tax under the view of the court

⁶ As evidently happened here: the value of each share of stock in the closely held corporation was the same at the creation of the trusts as at Fabrice's death 12-13 years later (R. 14).

of appeals) rather than original principal (which is so subject).

We find no basis for imputing to Congress an intent to create such an opportunity for tax avoidance by the manipulation of stock in a closely held corporation. The value of the decedent's estate, for federal tax purposes, is the value of the property includible in the estate at the date of his death. If the decedent establishes a trust consisting of shares of stock in a corporation he controls, and decides to retain the earnings in the corporation, the retained earnings will be reflected in the value of the stock; and hence both the original value of the stock and the value of the retained earnings will be includible if, as here, he has retained a string over the property transferred in trust. If, instead, he decides to distribute the earnings as dividends, but then retains the dividends in the trust, the effect is precisely the same; and we submit that the estate tax consequences should also be the same.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1965.

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No. 127

IN THE

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October Term, 1935

UNITED STATES OF AMERICA,

Petitioner,

v.

CHARLES E. O'MALLEY, CLAUDE G. ALEXANDER and PETER
G. FARROW, as Executors of the Will of EDWARD H.
FARRICE, deceased,

Respondents.

On Writ of Certiorari to the United States Court of Appeals
for the Seventh Circuit.

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BRIEF FOR RESPONDENTS

QUESTION PRESENTED

Almost thirteen years before his death, the decedent created five irrevocable trusts. He did not retain an income or remainder interest in any of the trusts, although he was one of the three co-trustees of each trust. Each trust was funded by the decedent on its creation, but no

other property was ever transferred by the decedent to the trusts. The trustees were directed to pay out trust income to the trust beneficiaries, but had the right to retain the income and add it to trust principal. A portion of the income was retained.

The question presented is whether the Court below correctly held that the retained trust income was not "transferred" by the decedent within the meaning of Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, and was not includable in his gross estate for federal estate tax purposes.

STATUTES INVOLVED

Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, as amended, is not sufficiently set forth in the brief of the United States. It provides in pertinent part:

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . . [t]o the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise . . . under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death . . . the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom . . ."

Omitted from the United States' brief is the phrase "(except in the case of a bona fide sale for an adequate and full consideration in money or money's worth)".

Other statutes cited in the Argument are set forth in an Appendix to this brief. They are: Internal Revenue Code of 1954, as amended, Section 641(a)(1) (26 U.S.C. 641(a)(1) (1964 ed.)); Internal Revenue Code of 1954, as amended, Section 2503(b) (26 U.S.C. 2503(b) (1964 ed.)); Internal Revenue Code of 1939, as amended, Sections 811(c) and (d) (26 U.S.C. 811(c), (d) (1952 ed.)); Internal Revenue Code of 1939, as amended, Section 1003(b)(3) (26 U.S.C. 1003(b)(3) (1952 ed.)).

STATEMENT

The statement of the United States is substantially correct. However, the only transfer of property by Fabrice to the trusts occurred when the trusts were created in December of 1936 and January of 1937—approximately thirteen years before Fabrice's death on October 13, 1949 (R. 2, 3, 4, 5). Fabrice retained no power to revoke, change, or modify the terms of the trusts for his benefit or in a manner by which he could ever acquire any interest in the corpus or income of the trusts (R. 57).

SUMMARY OF ARGUMENT.

The retained income of the trusts was never "transferred" by Fabrice within the meaning of Section 811(c) (1)(B)(ii) of the Internal Revenue Code of 1939. Neither the Congressional policy behind the Code's "transfer" sections, nor the statutory language itself, permits taxation of the mere accumulation of income on transferred property. That income was owned by the irrevocable trusts and the trustees merely directed that the trusts retain it.

It is fallacious to argue that the transfer of principal to the trusts was incomplete until the decedent's death and that the retained income therefore was "transferred" at

his death. The doctrine of an incomplete transfer was enunciated primarily in cases involving either revocable trusts or trusts where the decedent retained an income interest for his life. The doctrine of these cases should not be forced upon the present situation by strained analogies. The United States would displace all traditional concepts of ownership by awkward fictions. The principal here is taxable by reference to the statutory language; this statutory language does not support the proposition that the retained income was transferred by the decedent either before or at his death.

No loophole would be opened by affirming the decision below. The right which Fabrice retained is so narrow, and the over-all tax savings so dubious, that the facts of this case can hardly serve as a guide for a sophisticated tax avoidance plan.

The term "transfer" is definite in meaning and should not be given the tortured construction which the United States urges. Because taxpayers must be able to rely upon a clearly articulated and rational taxing system, Section 811(c)(1)(B)(ii) should be interpreted so as to give effect to the ordinary meaning of its terms. Any tax reform that would run contrary to the clear meaning of the statutory language should be left to Congress.

ARGUMENT.

A. Section 811(c)(1)(B)(ii) of the Internal Revenue Code of 1939, as amended (26 U.S.C. 811(c)(1)(B)(ii) (1952 ed.)), applies only to property "of which the decedent has at any time made a *transfer . . .*" (Emphasis added.) As the United States concedes in its brief (p. 7), the only real issue is whether Fabrice "made a transfer" of the retained income. A proper reading of Section 811(c)(1)(B)(ii) and an analysis of the statutory scheme in which the section appears conclusively demonstrate that the income earned by the irrevocable trusts was not "transferred" by Fabrice within the meaning of the section. That income therefore is not includable in Fabrice's gross estate. W

The basic policy behind the so-called "transfer" sections of the Internal Revenue Code of 1939 (26 U.S.C. 811(c), (d) (1952 ed.)), is to force into a decedent's gross estate for federal estate tax purposes, certain of the property which he once owned but subsequently transferred away. Property so taxed includes "transferred" property over which the decedent retained some measure of control, such as a life estate in it or the power to revoke a trust holding title to it.

Despite theoretical distinctions which are often drawn in estate tax problems, the federal estate tax law is essentially a pragmatic statutory system, designed to ignore legal fictions and to look to substance. See *Commissioner v. Estate of Church*, 335 U.S. 632, 644-45. The requirement of Section 811(c)(1)(B)(ii) that a "transfer" occur illustrates the pragmatic basis of the estate tax. This section requires inclusion in a decedent's gross estate of property] /

which he once owned and then "transferred", but over which he retained sufficient control to lead to the tax conclusion that it remained "his". Fabrice's estate thus has been taxed on the trust principle, because he once owned it and then transferred it subject to sufficient control to call for its inclusion in his gross estate.

But Fabrice never *owned* the retained income, and thus had nothing to "transfer" within the meaning of the statute. That income, under customary principles of property law, belonged to the trusts. Fabrice could not keep it himself, could not enjoy it, could not sell the right to it, could not cause it to be delivered to anyone but the trust beneficiaries. His sole right over it was, in conjunction with his co-trustees, to retain it in the trusts rather than to pay it out. As retained income, it would ultimately go to the trust beneficiaries. If there was a "transfer", it was not by Fabrice, because he had nothing to transfer. There was, moreover, no "transfer" of income at all. The trusts owned the income and retained it. The only income transferred was the trust income paid to the beneficiaries or expended for trust expenses, but there is no suggestion that it, too, is subject to federal estate tax.

A close analysis of the statutory language shows clearly that retained income was never meant to be taxed:

First, Section 811(c) contains an express exception for transfers involving a "sale for an adequate and full consideration in money or money's worth". This exception illustrates the Congressional purpose to tax only those interests which a decedent owned and could have sold. If the decedent did not own it, he could not have sold it. The exception is meaningless if the "property" referred to in the statute was never subject to sale by the decedent. If the

decedent did not own and could not have sold the property, he could not have "made a transfer" of it under the statute. The taxation of the principal fully satisfies the pragmatic requirements of Section 811(c)(1)(B)(ii).

Second, the statute commences by ". . . including the value at the time of his death of all *property* . . . [t]o the extent of any interest therein of which the decedent has at any time made a *transfer*" (Emphasis added.) When the statute refers to the type of control which will force this transferred property into the estate for tax purposes, the statute then, and only then, recognizes "income" as well as "property," for it refers to control as ". . . the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom" (Emphasis added.) Omission of the word "income" from the transfer provision evidences the Congressional intent to tax only transferred property and not retained income.

B. The United States argues, despite the clear statutory language, that the transfer of the original principal was "incomplete", and that therefore the transfer both as to principal and as to retained income took place only at the decedent's death (p. 8-9). That argument seeks to avoid what would otherwise have to be a tortured and illogical construction of the term "transfer" in Section 811(c)(1)(B)(ii). The argument is, however, completely misplaced here.

The "completeness" of a trust transfer was dealt with in *Commissioner v. Estate of Church*, 335 U.S. 632, 644-645 (cited by the United States at p. 5 of its brief):

"How is it possible to call this trust transfer 'complete' except by invoking a fiction? Church was sole owner of the stocks before the transfer. Probably their

greatest property value to Church was his continuing right to get their income. After legal title to the stocks was transferred, somebody still owned a property right in the stock income. That property right did not pass to the trust beneficiaries when the trust was executed; it remained in Church until he died. He made no 'complete' gift effective before that date, unless we view the trust transfer as a 'complete' gift to the trustees. But Church gave the trustees nothing, either partially or completely. He transferred no right to them to get and spend the stock income. And under the teaching of the *Hallock* case, quite in contrast to that of *May v. Heiner*, passage of the mere technical legal title to a trustee is not necessarily crucial in determining whether and when a gift becomes 'complete' for estate tax purposes. Looking to substance and not merely to form, as we must unless we depart from the teaching of *Hallock*, the inescapable fact is that Church retained for himself until death a most valuable property right in these stocks — the right to get and to spend their income. . . ."

That the transfer in *Church* was incomplete seems obvious. But how can the facts of *Church* be compared to those here? Fabrice did not retain the right to the income. He transferred to the trustees the irrevocable right to get and spend the income. The United States here asks the Court to ignore the substance of the Fabrice situation and to use the fiction of an "incomplete" transfer to trap the retained income. This is not necessary under the statute in order to tax the principal, and would be an unwarranted extension of *Church* for the purpose of taxing the retained income where the plain statutory language does not tax it.

Other cases cited by the United States (p. 5) are equally inapposite. In *Commissioner v. Estate of Holmes*, 326 U.S. 480, the decedent reserved the right during his lifetime to terminate the trusts and to distribute all of the trust property to the beneficiaries then entitled to receive it.

The issue there was whether that right to terminate fell within the statutory language of "alter, amend, or revoke". The Court held that it did. Fabrice had no such right.

Reinecke v. Northern Trust Co., 278 U.S. 339, dealt with two revocable trusts in which the decedent reserved a life income interest. The Court held those transfers not complete until the decedent's death, because they were revocable until the decedent died. The decision has no application here.

In short, the argument of an "incomplete" transfer is based primarily on cases which do not involve—as this case does—irrevocable trusts in which the decedent retained no income or remainder interest. The argument cannot be accepted and applied here except by doing violence to the facts.

The United States also argues that for purposes of estate tax law all traditional concepts of ownership must be abandoned in order to force retained income as well as principal into Fabrice's gross estate (p. 9). This, of course, simply begs the question. The reservation of the power to distribute or retain income may have forced the trust principal into Fabrice's gross estate for federal estate tax purposes, but there is no statutory or logical justification for claiming an ownership interest was thus created in the retained income which Fabrice could "transfer" within the meaning of the express statutory language.

The United States' analogy to the gift tax provisions of the Internal Revenue Code (p. 9) is also misplaced, because a vital point is ignored: the amount of gift tax depends directly upon the number of donees, the nature of the gifts to them, and when the gifts are made. Present interest gifts (such as distributions of income to a trust beneficiary) are entitled to an annual exclusion of the first \$3,000 to each donee; but future interest gifts (such

as income accumulations for ultimate distribution to a trust remainderman) are not entitled to that exclusion. Section 1003(b)(3) of the Internal Revenue Code of 1939, as amended (26 U.S.C. 1003(b)(3) (1952 ed.)) and Section 2503(b) of the Internal Revenue Code of 1954, as amended (26 U.S.C. 2503(b) (1964 ed.)). Thus, an essential criterion for accurate determination of the gift tax is the rule that the gift is deemed made only when the settlor directs either distribution or accumulation.

The estate tax law has no comparable provisions. No sound reason exists, therefore, for applying the gift tax rule in this situation, and the United States can cite no authority for its unique proposition.

C. The result below opens no loophole, as the United States suggests (pps. 10-12). The hypothetical taxpayer described by the United States, were he to rely on an affirmance of the decision below, would have only one inducement for patterning his actions on the facts of this case. That one inducement would be the right, with his co-trustees, to retain in an irrevocable trust a portion of the trust income. The estate tax savings on the retained income would be no inducement, for he could get that savings merely by foregoing the right to vote on retention of income. What price would he have to pay for that narrow right, under the hypothetical facts stated by the United States? His corporation would have to declare dividends payable to the trust and the trust would have to retain those dividends. Those retained dividends would, however, be taxable income to the trust, and income tax on them would have to be paid. Section 641(a)(1) of the Internal Revenue Code of 1954, as amended (26 U.S.C. 641(a)(1) (1964 ed.)). How then can the United States say (p. 11) that if trust income is accumulated " . . . the value of the trust will presumably be the same at his death as if

the earnings had been retained in the corporation"? In the first instance income tax is payable, and in the second instance it is not. The fact is that in the suggested hypothetical situation the income tax paid might well exceed the estate tax saved. Furthermore, the income tax is payable during the decedent's lifetime but the estate tax only after he dies.

The financial advantages of the so-called loophole are ephemeral at best, and would not afford a sound reason to retain the narrow power which Fabrice retained. Surely this Court should not anticipate that one interested in tax avoidance would deliberately keep so restricted a power if the price is (1) the certain taxability of principal and (2) the likelihood of paying more taxes on retained income than would be paid if the power were not kept.

D. No case cited by the United States, nor any case decided by this Court, compels the result the United States seeks. *Commissioner v. Estate of Church*, 335 U.S. 632, *Commissioner v. Estate of Holmes*, 326 U.S. 480, *Reinecke v. Northern Trust Co.*, 278 U.S. 339, and *Lober v. United States*, 346 U.S. 335, were all concerned with the nature of the control retained over property which was once owned by the decedent and "transferred" by him prior to death. In each case the transfer was clear, and involved specific property which the decedent at one time owned. This Court has never held, nor would the statutory language support a holding, that the mere power to retain income in an irrevocable trust creates an ownership in that income, which can be "transferred" by a decedent who never actually owned it. In closely analogous situations, the courts of appeals have held that the mere accumulation of income on transferred property is not subject to federal estate tax. *Commissioner v. Gidwitz' Estate*, 196 F. 2d 813 (7th Cir.); *Burns v. Commissioner*, 177 F.2d 739 (5th Cir.).

In *Commissioner v. McDermott's Estate*, 222 F.2d 665, 668 (7th Cir.), which is directly in point, the Court reasoned:

"Irrespective of all other considerations, property to be includible must have been transferred. Obviously, the accumulations here involved were not transferred by the decedent to the trustee. It is true, of course, that the accumulations represented the fruit derived from the property which was transferred but, even so, Congress did not make provision for including the fruit, it provided only for the property transferred. If it desired and intended to include the accumulations, it would have been a simple matter for it to have so stated."

The same reasoning has been followed by other courts. The Court of Appeals for the Sixth Circuit, in *Michigan Trust Co. v. Kavanagh*, 284 F.2d 502, followed *McDermott* with approval, stating at p. 506:

"There remains the question whether income represented by dividends on corporate stock is includible in the estate of the decedent. The Seventh Circuit Court of Appeals, on comparable facts and with careful discussion, rejected this concept. *Commissioner of Internal Revenue v. McDermott's Estate*, 7 Cir., 222 F.2d 665, 55 A.L.R. 2d 410. It applied its own rationalization in *Commissioner of Internal Revenue v. Gidwitz' Estate*, 7 Cir., 196 F.2d 813. In both cases, it was argued on behalf of the taxing authorities that transfers were not complete until decedent's death. The [lower court here] pointed out that the transfers from Hook to himself, as trustee, were fully completed when made in 1931. The securities transferred constituted the corpus of the estate and nothing remained to be done to complete the transfer. It is to be noted that the Tax Court, as recently as 1959, gives full effect to the *McDermott* decision. *McGehee, Estate of Delia Crawford*, 28 T.C. 412."

Although not directly in point because it involved the taxability in a donor's estate of stock dividends, paid out of current earnings on shares of stock given away by the donor in contemplation of death, *McGehee v. Commissioner*, 260 F.2d 818 (C.A. 5th) supports the rationale of *McDermott*. The Court said, 260 F.2d 818, 820:

"It is the interest of the decedent of which a transfer has been made which is to be included in the taxable estate of the donor. . . . The stock dividends were declared out of profits of the corporation earned subsequent to the gifts and hence were not a proportionate part of the corporation's assets at the time of the gift. This being so, it follows that the deceased donor never had any interest in the shares which were distributed as stock dividends or in the corporate earnings which the dividends capitalized. Although the tax is to be measured by the value of the transferred property as of the date of the donor's death, this does not mean that, for the purpose of determining what property was transferred, the gifts should be regarded as having been made as of the date of death. It has been held, and properly so, that income earned by previously taxed property should not be regarded as previously taxed property. *Gray v. Commissioner*, 19 B.T.A. 455. So also, we think, a stock dividend distributed as a capitalization of income of a corporation earned subsequent to a gift of the shares upon which the dividend was declared should not be regarded as a part of the gift."

E. The rule that the clear meaning of statutory terms should ordinarily govern is particularly persuasive in the field of taxation. Taxpayers and their attorneys should be able to govern their conduct by a taxing system which is both rational and based upon easily ascertainable criteria. Thus, the rule has developed that taxing statutes should be construed strictly in favor of the taxpayer; interpretations consonant with the ordinary meaning of the terms utilized are preferred. *Maass v. Higgins*, 312 U.S. 443; *Crooks v. Harrelson*, 282 U.S. 55. ✓

Another maxim particularly appropriate to tax cases is that courts will not, by judicial fiat, give an effect to a statute which Congress has not clearly intended. The uniformity demanded by a statutory tax scheme does not permit piecemeal alteration by the process of *stare decisis*. Such a piecemeal approach only creates more problems than it resolves. The tax laws are so rigidly compartmentalized that it is difficult to forecast the scope of a court decision beyond the facts at issue. Such unforeseen problems, frequently appearing in the tax field, underscore the advisability of leaving tax reform to Congress. See *Commissioner v. Brown*, 380 U.S. 563, 579; *American Automobile Ass'n. v. United States*, 367 U.S. 687, 697.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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December, 1965

APPENDIX

THE APPENDIX

OF THE

REPORT OF THE

COMMISSIONER OF THE

LAND OFFICE

FOR THE YEAR

1880

APPENDIX

Sections 811(c) and 811(d).

The following are the federal estate tax "transfer" sections of the Internal Revenue Code of 1939 (26 U.S.C. 811(c), (d) (1952 ed.)):

"§811. Gross estate.

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

• • •

"(c) Transfers in contemplation of, or taking effect at, death.

"(1) General rule.

"To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(A) in contemplation of his death; or

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

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“(2) Transfers taking effect at death—transfers prior to October 8, 1949.

“An interest in property of which the decedent made a transfer, on or before October 7, 1949, intended to take effect in possession or enjoyment at or after his death shall not be included in his gross estate under paragraph (1) (C) of this subsection unless the decedent has retained a reversionary interest in the property, arising by the express terms of the instrument of transfer and not by operation of law, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 per centum of the value of such property. For the purposes of this paragraph, the term ‘reversionary interest’ includes a possibility that property transferred by the decedent (A) may return to him or his estate, or (B) may be subject to a power of disposition by him, but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent’s death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Commissioner with the approval of the Secretary. In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate.

“(3) Transfers taking effect at death—transfers after October 7, 1949.

“An interest in property transferred by the decedent after October 7, 1949, shall be included in his gross estate under paragraph (1) (C) of this subsection (whether or not the decedent retained any right or interest in the property transferred) if and only if—

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(A) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent; or

(B) under alternative contingencies provided by the terms of the transfer, possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the earlier to occur of (i) the decedent's death or (ii) some other event; and such other event did not in fact occur during the decedent's life.

Notwithstanding the foregoing sentence, an interest so transferred shall not be included in the decedent's gross estate under paragraph (1) (C) of this subsection if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a power of appointment (as defined in section 811 (f) (2)) which in fact was exercisable immediately prior to the decedent's death.

“(d) *Revocable transfers—(1) Transfers after June 22, 1936.*

“To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

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“(2) Transfers on or prior to June 22, 1936.

“To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph;

“(3) Date of existence of power.

“For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.”

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Section 641(a)(1).

The following is the section of the Internal Revenue Code of 1954 which subjects trusts to income tax on their accumulated income (26 U.S.C. 641(a)(1) (1964 ed.)):

“§ 641. *Imposition of tax.*

“(a) *Application of tax.*

“The taxes imposed by this chapter on individuals shall apply to the taxable income of estates or of any kind of property held in trust, including —

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust; . . . ”

Sections 1003(b)(3) and 2503(b).

The following are the sections of the Internal Revenue Code of 1939 and of the Internal Revenue Code of 1954 which grant \$3,000 annual exclusions from gift tax for present interest gifts (26 U.S.C. 1003(b)(3) (1952 ed.); 26 U.S.C. 2503(b) (1964 ed.)):

“§ 1003. *Net gifts*—(a) *General definition.*

“The term ‘net gifts’ means the total amount of gifts made during the calendar year, less the deductions provided in section 1004.

• • •

“(b)(3) *Gifts after 1942.*

“In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1943 and subsequent calendar years, the first \$3,000 of such gifts to such

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person shall not, for the purposes of subsection (a), be included in the total amount of gifts made during such year."

"§ 2503. *Taxable gifts.*

"(a) *General definition.*

"The term 'taxable gifts' means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (sec. 2521 and following).

"(b) *Exclusions from gifts.*

"In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1955 and subsequent calendar years, the first \$3,000 of such gifts to such persons shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person."

SUPREME COURT OF THE UNITED STATES

No. 127.—OCTOBER TERM, 1965.

United States, Petitioner,	} On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.
v.	
Charles E. O'Malley et al.	

[March 23, 1966.]

MR. JUSTICE WHITE delivered the opinion of the Court.

The Internal Revenue Code of 1939 imposes an estate tax "upon the transfer of the net estate of every decedent." § 810. The gross estate is to include not only all property "to the extent of the interest therein of the decedent at the time of his death," § 811 (a), but also, under § 811 (c)(1), all property

"To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

"(A) in contemplation of his death; or

"(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or¹

"(C) intended to take effect in possession or enjoyment at or after his death,"

¹ Section 2036 of the Int. Rev. Code of 1954, as amended, 26 U. S. C. § 2036 (1964 ed.), is materially the same as § 811 (c)(1)(B) of the Int. Rev. Code of 1939.

and, under § 811 (d), property which has been the subject of a revocable transfer described in that section.²

Edward H. Fabrice, who died in 1949, created five irrevocable trusts in 1936 and 1937, two for each of two daughters and one for his wife. He was one of three trustees of the trusts, each of which provided that the trustees, in their sole discretion, could pay trust income to the beneficiary or accumulate the income, in which event it became part of the principal of the trust.³ Basing his action on § 811 (c)(1)(B)(ii) and § 811 (d)(1), the Commissioner included in Fabrice's gross estate both the original principal of the trusts and the accumulated income added thereto. He accordingly assessed a deficiency, the payment of which prompted this refund action by the respondents, the executors of the estate. The District Court found the original corpus of the trusts includable in the estate, a holding not challenged in the Court of Appeals or here. It felt obliged, how-

² Section 811 (d)(1) provides:

"To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death."

³ The following provision in the trust for Janet Fabrice is also contained in the other trusts:

"The net income from the Trust Estate shall be paid, in whole or in part, to my daughter, JANET FABRICE, in such proportions, amounts and at such times as the Trustees may, from time to time, in their sole discretion, determine, or said net income may be retained by the Trustees and credited to the account of said beneficiary, and any income not distributed in any calendar year shall become a part of the principal of the Trust Estate."

ever, by *Commissioner v. McDermott's Estate*, 222 F. 2d 665, to exclude from the taxable estate the portion of the trust principal representing accumulated income and to order an appropriate refund. 220 F. Supp. 30. The Court of Appeals affirmed, 340 F. 2d 930, adhering to its own decision in *McDermott's Estate* and noting its disagreement with *Estate of Round v. Commissioner*, 332 F. 2d 590, in which the Court of Appeals for the First Circuit declined to follow *McDermott's Estate*. Because of these conflicting decisions we granted certiorari. 382 U. S. 810. We now reverse the decision below.

The applicability of § 811 (c)(1)(B)(ii), upon which the United States now stands, depends upon the answer to two inquiries relevant to the facts of this case: first, whether Fabrice retained a power "to designate the persons who shall possess or enjoy the property or the income therefrom"; and second, whether the property sought to be included, namely, the portions of trust principal representing accumulated income, was the subject of a previous transfer by Fabrice.

Section 811 (c)(1)(B)(ii), which originated in 1931, was an important part of the congressional response to *May v. Heiner*, 281 U. S. 238, and its offspring⁴ and of

⁴ In *May v. Heiner* the Court dealt with a trust providing for payment of income to the spouse for his life, then to the grantor for her life, with remainder to the children. The corpus of the trust was held not includable in the gross estate under Revenue Act of 1918, c. 18, § 402 (c), 40 Stat. 1097, which was the predecessor of § 811 (c), I. R. C. 1939, and which then provided for the inclusion of all property "... to the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death" 281 U. S. 238, 244. There followed on March 2, 1931, three *per curiam* opinions in the same vein: *Burnet v. Northern Trust Co.*, 283 U. S. 782 (grantor reserved life interest in income); *Morsman v. Burnet*, 283 U. S. 783 (the same); *McCormick*

the legislative policy of subjecting to tax all property which has been the subject of an incomplete *inter vivos* transfer. Cf. *Commissioner v. Estate of Church*, 335 U. S. 632, 644-645; *Helvering v. Hallock*, 309 U. S. 106, 114. The section requires the property to be included not only when the grantor himself has the right to its income but also when he has the right to designate those who may possess and enjoy it. Here Fabrice was empowered, with the other trustees, to distribute the trust income to the income beneficiaries or to accumulate it and add it to the principal, thereby denying to the beneficiaries the privilege of immediate enjoyment and conditioning their eventual enjoyment upon surviving the termination of the trust. This is a significant power, see *Commissioner v. Estate of Holmes*, 326 U. S. 480, 487, and of sufficient substance to be deemed the power to "designate" within the meaning of § 811 (c)(1)(B)(ii). This was the holding of the Tax Court and the Court of

v. Burnet, 283 U. S. 784 (trustees directed to accumulate income subject to power in the grantor to request distributions for certain specified purposes. Grantor also had a power to terminate contingent upon approval of any one beneficiary and a remainder interest contingent upon surviving all named beneficiaries). On March 3, 1931, § 302 (c) of the Revenue Act of 1926 was amended by joint resolution to read as follows:

"To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, including a transfer under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property or (2) the right to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth." Revenue Act of 1926, c. 27, § 302 (c), 44 Stat. 70, as amended, c. 454, § 302 (c), 46 Stat. 1516.

Through various amendments in other years, § 302 (c) evolved into § 811 (c), Int. Rev. Code of 1939.

Appeals almost 20 years ago. *Industrial Trust Co. v. Commissioner*, 165 F. 2d 142, affirming in this respect *Estate of Budlong v. Commissioner*, 7 T. C. 756. The District Court here followed *Industrial Trust* and affirmed the includability of the original principal of each of the Fabrice trusts. That ruling is not now disputed. By the same token, the first condition to taxing accumulated income added to the principal is satisfied, for the income from these increments to principal was subject to the identical power in Fabrice to distribute or accumulate until the very moment of his death.

The dispute in this case relates to the second condition to the applicability of § 811 (c)(1)(B)(ii)—whether Fabrice had ever “transferred” the income additions to the trust principal. Contrary to the judgment of the Court of Appeals, we are sure that he had. At the time Fabrice established these trusts, he owned all of the rights to the property transferred, a major aspect of which was his right to the present and future income produced by that property. *Commissioner v. Estate of Church*, 335 U. S. 632, 644. With the creation of the trusts, he relinquished all of his rights to income except the power to distribute that income to the income beneficiaries or to accumulate it and hold it for the remaindermen of the trusts. He no longer had, for example, the right to income for his own benefit or to have it distributed to any other than the trust beneficiaries. Moreover, with respect to the very additions to principal now at issue, he exercised his retained power to distribute or accumulate income, choosing to do the latter and thereby adding to the principal of the trusts. All income increments to trust principal are therefore traceable to Fabrice himself, by virtue of the original transfer and the exercise of the power to accumulate. Before the creation of the trusts, Fabrice owned all rights to the property and to its income. By the time of his death he had divested

himself of all power and control over accumulated income which had been added to the principal, except the power to deal with the income from such additions. With respect to each addition to trust principal from accumulated income, Fabrice had clearly made a "transfer" as required by § 811 (c)(1)(B)(ii). Under that section, the power over income retained by Fabrice is sufficient to require the inclusion of the original corpus of the trust in his gross estate. The accumulated income added to principal is subject to the same power and is likewise includable. *Estate of Round v. Commissioner*, 332 F. 2d 590; *Estate of Yawkey v. Commissioner*, 12 T. C. 1164.⁵

Respondents rely upon two cases in which the Tax Court and two circuit courts of appeals have concluded that where an irrevocable *inter vivos* transfer in trust, not incomplete in any respect, is subjected to tax as a gift in contemplation of death under § 811 (c), the income of the trust accumulated prior to the grantor's death is not includable in the gross estate. *Commissioner v. Gidwitz' Estate*, 196 F. 2d 813, affirming 14 T. C. 1263; *Burns v. Commissioner*, 177 F. 2d 739, affirming 9 T. C. 979. The courts in those cases considered the taxable event to be a completed *inter vivos* transfer, not a transfer at death, and the property includable to be only the property subject to that transfer. The value of that property, whatever the valuation date, was apparently deemed an adequate reflection of any income

⁵ This same result was reached, but without discussion, in *Estate of Spiegel v. Commissioner*, 335 U. S. 701, under the "take effect in possession or enjoyment" provision of § 811 (c) and in *Commissioner v. Estate of Holmes*, 326 U. S. 480, under § 811 (d). Other cases reaching the same conclusion under § 811 (d) or its predecessors are *Commissioner v. Estate of Hager*, 173 F. 2d 613, petition for cert. dismissed, 337 U. S. 937; *Estate of Showers v. Commissioner*, 14 T. C. 902; *Estate of Guggenheim v. Commissioner*, 40 B. T. A. 181, aff'd, 117 F. 2d 469, cert. denied, 314 U. S. 621.

rights included in the transfer since the grantor retained no interest in the property and no power over income which might justify the addition of subsequently accumulated income to his own gross estate. Cf. *Maass v. Higgins*, 312 U. S. 443.

This reasoning, however, does not solve those cases arising under other provisions of § 811. The courts in both *Burns*, 9 T. C. 979, 988-989 and *Gidwitz*, 196 F. 2d 813, 817-818, expressly distinguished those situations where the grantor retains an interest in a property or its income, or a power over either, and his death is a significant step in effecting a transfer which began *inter vivos* but which becomes final and complete only with his demise. *McDermott's Estate* failed to note this distinction and represents an erroneous extension of *Gidwitz*.⁶ In both *McDermott* and the case before us now, the grantor reserved the power to accumulate or distribute income. This power he exercised by accumulating and adding income to principal and this same power he held until the moment of his death with respect to both the original principal and the accumulated income. In these circumstances, § 811 (c)(1)(B)(ii) requires inclusion in *Fabrice's* gross estate of all of the trust principal, including those portions representing accumulated income.

Reversed.

⁶ The Court of Appeals in *McDermott's Estate* was clearly wrong in saying that the transfer there involved was as complete as was the transfer in *Gidwitz*. In *Gidwitz* the transfer was in trust and the grantor was one of the trustees but there was a specific direction to accumulate with no discretionary powers in the trustees over either income or principal. In *McDermott*, as in this case, the grantor retained the power, with other trustees, to accumulate or distribute trust income.

SUPREME COURT OF THE UNITED STATES

No. 127.—OCTOBER TERM, 1965.

United States, Petitioner,	} On Writ of Certiorari to the	
v.		United States Court of
Charles E. O'Malley et al.		Appeals for the Seventh Circuit.

[March 23, 1966.]

MR. JUSTICE STEWART, with whom MR. JUSTICE HARLAN joins, dissenting.

In the 1930's Edward Fabrice made an irrevocable transfer of certain property to trusts for the benefit of his wife and daughters. Twelve years later he died. Because of the provisions of § 811 (c)(1)(B)(ii) of the Internal Revenue Code of 1939,¹ the value of the property Fabrice had irrevocably transferred was nonetheless included in his gross estate for estate tax purposes. The respondents do not question the correctness of that determination. But in this case the Court holds that the accumulated income which that property generated during the 12 years that elapsed after Fabrice had irrevocably transferred it is also to be included in his gross estate under § 811 (c)(1)(B)(ii). I think the Court misreads the statute.

By its terms the statutory provision applies only to property "of which the decedent has at any time made a transfer." Fabrice "made a transfer" only of the original trust corpus. He never "made a transfer" of the income which the corpus thereafter produced, whether accumulated or not.² I can put the matter no more

¹ The relevant text of the statute is set out on page 1 of the Court's opinion.

² The value of the original trust corpus at the time of transfer and at the time of Fabrice's death no doubt reflected its income-producing capacity.

clearly than did the Court of Appeals for the Seventh Circuit in *Commissioner v. McDermott's Estate*, 222 F. 2d 665, 668:

"Irrespective of all other considerations, property to be includible must have been transferred. Obviously, the accumulations here involved were not transferred by the decedent to the trustee. It is true, of course, that the accumulations represented the fruit derived from the property which was transferred but, even so, Congress did not make provision for including the fruit, it provided only for the property transferred. If it desired and intended to include the accumulations, it would have been a simple matter for it to have so stated."

See also *Michigan Trust Co. v. Kavanagh*, 284 F. 2d 502, 506-507 (C. A. 6th Cir.).

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